DRAFT

PUBLIC UTILITIES COMMISSION OF THE STATE OF CALIFORNIA

Item 61 ID#3544

ENERGY DIVISION **RESOLUTION E-3866**

July 8, 2004

R E S O L U T I O N

Resolution E-3866. Certification to the Securities and Exchange Commission (SEC) whether the California Public Utilities Commission (Commission) has the resources and authority to safeguard the interests of California customers of PacifiCorp, an indirect utility subsidiary of ScottishPower plc (ScottishPower), a holding company registered with the SEC under the Public Utility Holding Company Act of 1935, as amended (PUHCA or the Act), 15 U.S.C. §§ 79a, et seq.

SEC Letter Dated March 11, 2004

SUMMARY

The Commission declines to certify to the SEC that the Commission has the ability to protect PacifiCorp customers if the SEC grants the expanded financing authority requested by ScottishPower.

This Resolution informs the SEC that the Commission may not have the ability to protect PacifiCorp's California customers from the potential adverse consequences related to the SEC's increasing the authorization for ScottishPower's and its subsidiaries'[1](Applicants) investment in exempt wholesale generators (EWGs) and

[1] The UK subsidiaries are Scottish Power NA 1 Limited, Scottish Power NA 2 Limited, Scottish Power UK Holdings Limited (SPUK Holdings), Scottish Power UK plc (SPUK), headquartered in Glasgow, Scotland UK. The US subsidiaries are PacifiCorp Holdings, Inc. (PHI), PacifiCorp, a utility subsidiary, and PacifiCorp Group Holdings Company (PGHC) - a non-utility Holding Company, all headquartered in Portland Oregon. PHI's non-utility subsidiaries are: PPM Energy Inc.; Pacific Klamath Energy Inc.; PacifiCorp Financial Services, Inc.; Energy West Mining Company, Glenrock Coal Company; Investment Mining Company; Pacific Mineral, Inc.; PacifiCorp Environmental Remediation Company; PacifiCorp Investment Management, Inc.; PACE Group, Inc.; Enstor, Inc.; Arlington Wind LLC; an Heartland Wind LLC, all located in Portland, Oregon.

foreign utility companies (FUCOs) from the current $4.68 billion to $12.5 billion because:

- $12.5 billion authority requested is more than four times ScottishPower's consolidated retained earnings as of September 30, 2003.
- Investments in EWGs and FUCOs generally cost several hundred millions of dollars and if two or three investments are woefully unprofitable, ScottishPower's retained earnings could be wiped out in a short time, particularly in light of the historical risk and instability of EWG and FUCO investments.
- There is a risk that should ScottishPower file for bankruptcy in the future the Commission would be unable to shield PacifiCorp customers from risk to PacifiCorp's assets.
- ScottishPower's additional debt may also result in a higher cost of debt to PacifiCorp.

BACKGROUND

The Commission approved ScottishPower's merger with PacifiCorp in 1999.

PacifiCorp is a public utility organized in the state of Oregon and providing electric service in California and the states of Oregon, Idaho, Utah, Washington, and Wyoming. D. 99-06-049, as amended by D.99-10-059, approved with conditions the joint request of PacifiCorp and ScottishPower for an exemption from the requirements of Public Utilities (PU) Code § 854 for the merger of an indirect, wholly-owned subsidiary of ScottishPower with and into PacifiCorp and ScottishPower's subsequent exercise of control over PacifiCorp. At that time, PacifiCorp provided electric service to 41,273 retail customers in its California service territory, which represented only 3.3% of its retail customers system-wide and 2% of its retail electricity sales system-wide. D.99-06-049, Findings of Fact No. 3, Mimeo at 16-17.

The SEC granted ScottishPower financing authorization to invest in FUCOs and EWGs up to $4.68 billion on December 6, 2000

After its acquisition of PacifiCorp on November 29, 1999, ScottishPower registered with the SEC under PUHCA as a holding company. By order dated December 6, 2000 (Financing Order), the SEC authorized ScottishPower and certain of its subsidiaries to engage in various financing transactions through March 31, 2004 (Current Authorization Period). The first SEC Financing Order for the Current Authorization Period was for various external financings and internal credit support arrangements. As relevant here, the FUCO and EWG authorization limit was $4.68 billion during the Current Authorization Period.

ScottishPower now requests substantially expanded financing authority from the SEC up to $12.5 billion.

ScottishPower now requests SEC authorization to increase ScottishPower's existing investment authority limit in EWGs and FUCOs to $12.5 billion, an increase of $7.82 billion, and to establish a new authorization period of April 1, 2004 through March 31, 2007 (Authorization Period).

The Application also requests authority for $8.0 billion of external financing and $2.0 billion of short-term financing limits in addition to $8.0 billion in guarantees and loans, and authority for PacifiCorp to issue $1.5 billion in commercial paper and promissory notes as part of the short-term debt limit. According to ScottishPower in its SEC showing that it is committed to maintain PacifiCorp's credit ratings[2] at investment grade. The Application may be viewed on the Office of Public Utility Regulation's website at: http://www.sec.gov/divisions/investment/opur/filing.htm.

The SEC solicits States' certification for the Applicants' additional authority.

On March 13, 2004, the President of the Commission received a letter dated March 11, 2004 from the Assistant Director of the SEC (SEC Letter) soliciting the views of the Commission regarding the Application for additional financing authority to invest in EWGs and FUCOs. The SEC sent a similar letter to state commissions in Idaho, Oregon, Washington, Utah, and Wyoming for their consideration.

Among other regulations, PUHCA limits the amount of investment by holding companies in EWGs and FUCOs. Because ScottishPower's request exceeds the safe harbor investment limits under PUHCA, SEC rules require that ScottishPower must affirmatively demonstrate that its use of financing proceeds to invest in EWGs and FUCOs will not have an "adverse impact" on any utility subsidiary or the ability of the state commissions to protect utility customers. Pursuant to Rule 53 under PUHCA, a holding company's "aggregate investment" in EWGs and FUCOs may not exceed 50% of the system's consolidated retained earnings. 17 C.F.R. § 250.53(a)(1). Accordingly, as stated in the SEC Letter, "Rule 53(c) under the Act requires that

[2] PacifiCorp's senior secured debt has a credit rating of "A3" and "A"; unsecured debt has a rating of "Baa1" and "BBB+"; preferred stock has a rating of "Baa3" and "BBB"; and commercial paper has a rating of P-2 and "A2" and "P2" by Moody's and Standard and Poor's (S&P), respectively.

Scottish Power affirmatively demonstrate that its use of financing proceeds to invest in EWGs and FUCOs will not have an "adverse impact on any utility subsidiary [of ScottishPower] or its customers, or on the ability of the State Commissions to protect such subsidiary or customers." See 17 CFR § 250.53(c).

SEC has given interim approval pending completion of the record.

On April 1, 2004, in Release No. 35-27831, 2004 SEC LEXIS 766 (Apri1 1, 2004) (Interim Decision), the SEC gave ScottishPower interim approval to enter into external financings, credit support arrangements, and other proposals, but reserved jurisdiction over whether to allow ScottishPower to increase its aggregate investment by up to $12.5 billion in EWGs and FUCOs pending completion of the record. Id. at *39-40. The Interim Decision states that the SEC did not receive any requests for a hearing. Id. at *3.

According to the Interim Decision, the $12.5 billion request represents current EWG/FUCO investments of $2.47 billion, plus an additional 320% of consolidated retained earnings, totaling approximately 420% of ScottishPower system's consolidated retained earnings. 2004 SEC LEXIS 766, at *38 and n.18.

NOTICE

The Draft Resolution was mailed on May 6, 2004 to PacifiCorp and interested persons or organizations for public review and comment and will be placed on the Commission's Agenda on June 9, 2004.

PROTESTS

There are no protests to the certification request by the SEC to the Commission.

DISCUSSION

The Energy Division has reviewed the Application filed with the SEC, the SEC Letter, PacifiCorp's letter dated April 30, 2004, and other related matters, including various files and decisions of the Commission. PacifiCorp continues to serve approximately 41,000 customers in Northern California. There are no OIIs or adjudicatory proceedings pending against PacifiCorp.

The Commission has broad powers to regulate PacifiCorp.

The California Constitution provides that the Commission may fix rates, establish rules, examine records, issue subpoenas, administer oaths, take testimony, punish for contempt, and prescribe a uniform system of accounts for all public utilities subject to its jurisdiction. Cal. Const. Art. 12, § 6. In addition to its Constitutional powers, the PU Code grants the Commission broad regulatory authority. Section 701 grants the Commission the authority to "supervise and regulate every public utility in the State and do … all things … which are necessary and convenient in the exercise of such power and jurisdiction." This authority includes the power to review and audit the books and records of PacifiCorp and its subsidiaries and affiliates with respect to their transactions with PacifiCorp.

Section 587 requires annual reporting to the Commission of significant transactions between PacifiCorp and its subsidiaries or affiliates, and § 314 provides Commission staff with access to all of PacifiCorp's books and records and those of its subsidiaries and affiliates with respect to any transactions between PacifiCorp and any affiliate or subsidiary on any matter that might adversely affect ratepayers. Further, the provisions of §§ 816-830 and § 851 grant the Commission the power to regulate and supervise PacifiCorp's issuance of securities, the encumbering of utility property within the state, and its assumption or guaranteeing of any liability with respect to securities of any other person. Section 701.5 specifically limits a public utility's authority to issue securities and pledge utility assets or credit on behalf of an affiliate. Finally, §§ 798, 827, 2100-2107, 2108-2110, 2113 and 2114 provide extensive enforcement authority and penalties for violations of California's public utility laws and Commission orders, including laws and orders regarding transactions with affiliates.

A ScottishPower Bankruptcy could prevent the Commission from protecting ratepayers.

The powers enumerated above may not protect PacifiCorp's utility assets and California customers from adverse consequences of unprofitable investments in EWGs and FUCOs. The increased investment authority could lead to a highly leveraged holding company since the amount of external financing of $8.0 billion could be in long-term debt, which is currently at 47% ($8.3 billion) of total capitalization of $18.0 billion.

It is public knowledge that many energy merchant companies are selling off their foreign and US investments in EWGs; an indication of the instability and risk associated with EWG and FUCO investments. One potential adverse consequence is a

bankruptcy filing in the UK or the United States as a result of two or three ventures' failing woefully. There are no provisions in ScottishPower's Application to the SEC to prevent PacifiCorp from being dragged into a bankruptcy filing by ScottishPower. We do not know if the rating agencies are receptive to the SEC's ring fencing provisions designed to protect holding companies' utility subsidiaries from the adverse effects of their parents' actions. We have no examples of how they have been applied in practice and enforced by the SEC. In the event of bankruptcy, the Commission's ability to protect PacifiCorp's utility assets and customers will depend on the particular fact situation presented, and the applicable law. Bankruptcy proceedings can be lengthy, contentious, and expensive, and their outcome cannot be predicted. We are not persuaded by PacifiCorp's response to the Energy Division's concern in its letter dated April 30, 2004 because the information came from the Application to the SEC that we have already analyzed and evaluated.

High leveraging of the holding company could increase the utility's financing costs.

The increased debt obligations or a downgrade of ScottishPower's credit ratings may have adverse consequences on PacifiCorp's cost of borrowing money. ScottishPower's credit ratings are linked to that of PacifiCorp. ScottishPower and PacifiCorp have not provided to the Commission any commitment or guarantee that the utility will be shielded from any such higher borrowing costs caused by ScottishPower's increased leveraging. Any downgrading of ScottishPower credit ratings as a result of increased debt obligations affect PacifiCorp's credit ratings.

The conditions imposed by the Commission as part of the merger authorization (D. 99-06-049) would not permit the Commission to protect ratepayers against the effects of higher financing costs or the risk of ScottishPower bankruptcy.

When the Commission granted the application of ScottishPower and PacifiCorp for an exemption from the merger requirements in PU Code § 854, the approval was subject to certain enumerated conditions, including:

- ScottishPower and PacifiCorp agree that in their management and operation of PacifiCorp in the state of California they will comply with the Commission's rules and regulations regarding public utilities and their affiliates.

- To determine the reasonableness of allocation factors used by ScottishPower to assign costs to PacifiCorp and amounts subject to allocation or direct charges, the Commission may

audit the accounts of ScottishPower and its affiliates, which are the bases for charges to PacifiCorp. ScottishPower and PacifiCorp agree to cooperate fully with such Commission audits.

- ScottishPower and PacifiCorp will provide the Commission access to all books of account, documents, and data of ScottishPower or its affiliates that pertain to transactions between PacifiCorp and ScottishPower or its affiliates.

- PacifiCorp will maintain its own accounting system, separate from ScottishPower's accounting system. PacifiCorp financial books and records will be kept in the United States.

- ScottishPower and PacifiCorp will make their officers and employees, and those of their affiliates, available to appear and testify, as necessary or required in Commission proceedings, in connection with future transactions between PacifiCorp and ScottishPower or its affiliates, and will bear the associated costs.

- If PacifiCorp sells or transfers its California distribution system, ScottishPower and PacifiCorp agree that PacifiCorp will first apply for an order of the Commission authorizing such sale in accordance with Public Utilities Code Section 851."[3]

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[3] In D.00-12-048, the Commission dismissed PacifiCorp's application to sell its California distribution assets, CPCNs and certain transmission assets to the Nor-Cal Electric Authority (Nor-Cal) and the Jefferson Public Power Authority (Jefferson). The principal grounds for the dismissal were that (1) a Superior Court judgment had held that Del Norte County, one of the two members of Jefferson, lacked the legal power to sell electric power on a retail basis, and (2) the legality of alternative arrangements the parties had negotiated had not been determined. However, D.00-12-048 noted that PacifiCorp was free "to file a new and complete application so that the Commission can decide applicant's transfer proposal on its merits." Mimeo at 9.

On November 1, 2001, PacifiCorp and Nor-Cal announced that they had reached an agreement in principle for the sale of above-noted PacifiCorp assets to Nor-Cal. The parties expect to finalize their agreement and file an application seeking this

Footnote continued on next page

D.99-06-049, Mimeo at 18-19. In addition to the principal conditions imposed by the Commission, ScottishPower agreed with the Office of Ratepayer Advocates (ORA) to certain performance standards and conditions in the following areas: (1) Customer Service, (2) Regulatory Oversight, (3) Commitment to the Environment, (4) Commitment to Communities, and (5) Commitment to Employees. These are included as Appendix A to D.99-06-049.

These conditions were imposed to prevent adverse consequences to PacifiCorp as a result of the merger. They were not imposed to limit ScottishPower's investment in EWGs and FUCOs and the adverse effects of such action or insulate PacifiCorp from its parent's bankruptcy protection.

The Commission reiterated the merger conditions in December 2001 when approving PacifiCorp's change of control

After the merger, PacifiCorp filed an application for an exemption from the requirements of PU Code § 854(a), which applies to mergers and other forms of reorganization that result in a change of control of a public utility. This application requested the transfer of all of the common stock of PacifiCorp from NA General Partnership; a Nevada partnership indirectly controlled by ScottishPower, to a newly formed Delaware holding company, PacifiCorp Holdings, Inc. (PHI), that is also an indirect subsidiary of ScottishPower.

D.01-12-013 granted this application, and noted that the conditions previously imposed by the Commission remained in effect. D.01-12-013, Mimeo at 14-16. PacifiCorp also was required to file a resolution agreeing to accept and abide by the conditions of D.99-06-049 and D.99-10-059 and to provide notice to the Commission prior to any transfer to PHI of any non-regulated business now held by PacifiCorp Group Holdings Company. Id. This resolution was filed on December 27, 2001.

Commission's approval of the transaction in January 2002. *See,* www.pacificorp.com/pages/Navigation6288.html.; *California Energy Markets,* November 2, 2001, page 2, ¶9. The Affiliate Transaction Report filed with the Commission Energy Division on May 1, 2003 for the 2002 record period states that PacifiCorp "continues to search for a workable solution…" for the sale of California service territory but has continued opposition from Siskiyou County.

COMMENTS

PU Code § 311(g)(1) provides that this Resolution be served on all interested persons and organizations (parties) and subject to at least 30 days public review and comment prior to a vote of the Commission. Section 311(g)(2) provides that this 30-day period may be reduced or waived upon the stipulation of all parties in the proceeding. The 30-day is not being waived or reduced. Accordingly, the Draft Resolution was mailed on May 6, 2004 to PacifiCorp and interested persons or organizations for public review and comment and will be placed on the Commission's Agenda on June 9, 2004.

On May 14, 2004, PacifiCorp filed comments on the Draft Resolution. PacifiCorp offered to accept three conditions in order to address the concerns raised by the Energy Division. On May 18, 2004, it supplemented its comments by proposing a minor change to one of the conditions. The three conditions have been incorporated in an Alternate Draft Resolution approving the certification to the SEC.

FINDINGS

1. On March 5, 2004, the SEC noticed the Application of ScottishPower, a foreign registered holding company with the SEC under PUHCA, 15 U.S.C. § 79a, et seq., and its direct and indirect subsidiaries for additional financing and acquisition authority.

2. ScottishPower's Application to the SEC includes a request for additional authority to increase investment in EWGs and FUCOs from $4.68 billion to $12.5 billion.

3. On March 13, 2004, the Commission received a letter from the SEC regarding ScottishPower's Application. The letter requests a certification from the Commission that it has the ability and resources to protect the California ratepayers of PacifiCorp, an indirect utility subsidiary of ScottishPower,

4. On April 1, 2004, the SEC provided its interim approval of ScottishPower's Application but reserved jurisdiction over whether to allow ScottishPower to increase its aggregate investment up to $12.5 billion in EWGs and FUCOs pending completion of the review.

5. Increased leveraging by ScottishPower could lead to higher financing costs to PacifiCorp.

6. The Commission may not be able to protect ratepayers should ScottishPower be forced into bankruptcy.

7. Although the Commission has broad power under California law, given the magnitude of potential adverse consequences of the increased investment authority, this power may not be sufficient to protect PacifiCorp's utility assets and customers.

8. We are not persuaded by PacifiCorp's response to the Energy Division's concerns in its letter dated April 30, 2004.

9. The Commission may not have the ability and resources to protect the interests of PacifiCorp California ratepayers if the Applicants' request is granted.

THEREFORE IT IS ORDERED THAT:

1. Because of the magnitude of the potentially adverse consequences of increasing ScottishPower's investment authority in EWGs and FUCOs from $4.68 billion to $12.5 billion, the Commission cannot certify to the SEC that the Commission has the authority and resources to protect the California customers of PacifiCorp.

2. PacifiCorp shall provide to the Commission the final order of the SEC on the ScottishPower Application not later than 15 days after it is issued. In addition, PacifiCorp shall provide the response of each state commission to the request of the SEC to the Commission not later than 20 days after it is issued by each state.

This Resolution is effective today.

I certify that the foregoing resolution was duly introduced, passed and adopted at a conference of the Public Utilities Commission of the State of California held on July 8, 2004, the following Commissioners voting favorably thereon:

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WILLIAM R. AHERN
Executive Director