

**BEFORE THE PUBLIC UTILITY COMMISSION**

**OF OREGON**

**UE 180**

In the Matter of )  
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 )  
 PORTLAND GENERAL ELECTRIC, )  
 )  
 Request for a General Rate Revision. )  
\_\_\_\_\_ )

**REPLY BRIEF  
OF THE  
CITIZENS' UTILITY BOARD OF OREGON**

December 1, 2006



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**I. Introduction**

Mercifully, this general rate case draws to a close.

Despite the half dozen stipulations entered into in this case and the issues resolved thereby, this case was marked by an intense disagreement on the issue of a regulatory framework to deal with net power costs. This disagreement has been building over several years and several dockets, and we sincerely hope that the Commission can use this opportunity to establish clear parameters for the power costs regulatory framework.

In addition, due to ICNU's examination of the relationship between PGE and Standard and Poor's, not only is a piece of evidence important to PGE's case called into question, a larger issue arises as to the value of credit agency reports.

In this brief, we attempt to highlight and clarify a few remaining points. We discuss: the burden of proof, PGE's use of the S&P report, PGE's proposed framework for regulatory costs, and the Port Westward prudence issue.

## **II. Burden of Proof**

It borders on the silly that we have to edify PGE on how the burden of proof works in cases before the Commission. We must because it appears as if PGE has forgotten. In its Opening Brief, PGE makes the argument that a party, in this case ICNU-CUB, is not free to substitute a different capital structure for the utility's proposed capital structure, because in the party's view the substitute is more reasonable. "Rather, the party must demonstrate that PGE's actual equity ratio of 53.3% is unreasonable or imprudent." PGE Opening Brief, p. 16. PGE then cites to two Maryland Public Service Commission cases and one Maine Supreme Court decision as support.

This is not how the burden of proof works in this state. PGE has the burden to show that proposed rates are just and reasonable. That means the utility must show that the components that make up the costs in the proposed test year are reasonably likely to occur and are prudent. The test year is representative of prudent business activity going forward. The capital structure is part of the test year. The actual capital structure, just like the actual power costs or actual administrative costs, may well be adjusted to reflect prudent and reasonable business practices and economic considerations going forward. It is the utility that bears the burden throughout the rate case to show that the proposed costs, and thus the capital structure that drives certain costs, are reasonable.

The Commission has directly addressed this issue, by saying:

We . . . affirm that, under ORS 757.210, the burden of showing that the proposed rate is just and reasonable is borne by the utility throughout the proceeding. Thus, if PGE makes a proposed change that is disputed by another party, PGE still has the burden to show, by a preponderance of

evidence, that the change is just and reasonable. If it fails to meet that burden, either because the opposing party presented compelling evidence in opposition to the proposal, or because PGE failed to present compelling information in the first place, then PGE does not prevail.

UE 115, Order No. 01-777, p. 6, August 31, 2001.

It is not ICNU-CUB's role to prove that the proposed cost is unreasonable or imprudent. It is PGE's role to show that the proposed cost is reasonable and prudent – throughout the case. The bulk of Mr. Gorman's testimony on behalf of ICNU-CUB concerns why PGE's proposed capital structure is not reasonable and why his proposal is more accurate and reasonable. The Commission may consider this testimony and weigh it against PGE's testimony, but ultimately the Commission must be convinced that PGE has carried the burden of proving why its proposal is reasonable and prudent.

### **III. PGE's Use of S&P Report**

PGE uses a Standard and Poor's September 25, 2006, report on PGE rather extensively for several purposes. In its Opening Brief, PGE argues against the return on equity proposals of Staff and ICNU-CUB, citing the report as evidence of concern by credit agencies. PGE said:

S&P's most recent report on PGE dates September 25, 2006 states that one of the reasons for the negative outlook is "an uncertain regulatory environment" and that "[w]eak financial performance could lead to lower ratings, particularly if it is the result of inadequate rate relief."

PGE Opening Brief, p. 30.

In testimony, PGE relied heavily on this S&P report to support PGE's arguments on how the credit agencies will view certain Commission policy decisions pertaining to deadbands and PCAs. PGE said:

A deadband applied to power cost recovery is suggestive of a less supportive regulatory climate because it implies that the utility will simply never recover certain costs, irrespective of whether the costs were prudently incurred or not. Recently, S&P changed its outlook on PGE to 'negative' and cited "an uncertain regulatory environment," and "power cost variations that cannot currently be passed through to customers" as concerns. S&P also stated that it could restore PGE's outlook to stable if, among other items, "a sufficiently supportive PCA mechanism is adopted in addition to extension of the RVM." Whether S&P believes that a deadband results in a "sufficiently supportive PCA" has yet to be seen.

PGE/2400/Lesh/16, footnote omitted.

It seems to us that PGE may have a better idea of what S&P is thinking than PGE is letting on. Due to ICNU's investigative work in this case and the discovery of the relationship between PGE and S&P, the value of this S&P report as evidence of an independent evaluation supporting PGE's position is less than zero. See ICNU Opening Brief, 5-12. As ICNU said in its Opening Brief:

S&P describes itself as "the world's foremost provider of *independent* credit ratings, indices, risk evaluation, investment research and data," but the Commission should give little weight to the views of entities that are not truly independent.

ICNU Op. Br. at 8, footnote 3; emphasis is original.

ICNU has made a clear case for why the September 25, 2006, S&P report should be given no evidentiary value. However, the larger question remains as to how much value a credit report holds as independent evidence if the utility has a "role in drafting the . . . report". Staff Opening Brief, p. 18. CUB is concerned about this turn of events and

encourages the Commission to delve into the true level of independent thinking that goes into credit reports, especially as they attempt to influence regulatory policy.

#### **IV. PGE's Proposed Regulatory Framework for Power Costs**

This has been a frustrating case for Staff and intervenors. On a number of matters relating to a net variable cost regulatory framework, PGE has changed its theories and arguments regularly as the case has developed. Rather than responding to parties' concerns about its proposed allocation of power cost risk in its rebuttal testimony, the Company developed a new concept of risk which it called "cost of service risk."

PGE/1800/Lesh/8-18. At that time PGE also developed a new theory that "cost-of-service ratemaking" requires using actual costs rather than forecasted costs. Id at 9.

PGE has proposed a power cost framework that is at odds with recent decisions by the PUC, but "did not acknowledge the Commission's policy, let alone address why it should not apply, until its surrebuttal testimony," after parties' opportunity to file testimony had passed. Staff Opening Brief, p. 1. PGE argued against a deadband in direct and rebuttal testimony, and only after other parties had finished their cases did the Company in surrebuttal propose its own model for a PCA with a deadband. Staff Op. Br., p. 1. Finally, in its Opening Brief, for the first time PGE argues that the Commission should "provide for an even allocation of the risk in its forecast of power costs." PGE Op. Br., p. 31. CUB shares Staff's concerns over "PGE's failure to meaningfully address the concerns and issues raised by other parties in this case" in a timely manner. Staff provides a good list of examples of this problem. Staff Op. Br., p. 1-3.

## A. PGE's Net Variable Power Cost - Cost of Service Risk

In Surrebuttal, CUB dismisses PGE's redefinition of risk, what the Company calls "cost-of-service risk."

According to PGE, the risk that the parties and the Commission should be concerned about is not the risk that actual power costs will be different from those that were forecast, but rather is the risk that regulation will not fully true-up the difference between forecasted and actual costs.

UE 180 CUB/300/Jenks-Brown/3-4.

Through a series of dockets over the last several years, the Commission and the parties to this case have been having a discussion about power cost risk. Until PGE's Rebuttal testimony, the risk that we were concerned about was the risk that actual power costs would be higher or lower than the forecast that was used to set rates.

By PGE's definition, "cost-of-service risk" is the risk that the Commission will not true-up forecast costs to the actual costs, and, therefore, both customers and the Company bear this risk:

Utilities bear the risk that test year rates, and revenues collected through them, are too low for the costs incurred in providing on-demand retail electric service. *PGE.1800, Lesh/9*. Customers bear the risks that test year rates, and bills they produce are too high for the actual costs a utility bears in providing the service. *Id.*

PGE Op. Br., p. 35.

From the Company's perspective the more complete the true-up, the less "cost-of-service risk" there is overall, and the happier everyone should be. As a result of this redefinition of risk, PGE developed a regulatory framework for the recovery of net power costs that did not include a deadband or any real sharing mechanism. But such a complete true-up adds volatility to rates and shifts the risk of normal variation in power costs forecasts from the utility to its customers. CUB/300/Jenks-Brown/22-24.

Much of the problem with PGE's power cost framework come from its failure to recognize that the risk that is being allocated is the risk that the forecast which is used to set rates will be incorrect. Actual costs will be different than forecasted costs. This is a fact of life for nearly all utility costs, and for nearly all utility costs the utility absorbs the risk that costs will be higher or lower than forecast. This makes sense because the utility is the entity that has the power to manage its costs and is being paid a return to do so prudently. What makes power costs different is the potential magnitude which can be greater than the utility's ability to absorb it. Collectively, customers have greater financial resources than a utility and when the power cost variations become too great, it is appropriate to ask customers to step in and take on this risk. CUB/300/Jenks-Brown/4-5.

It is this traditional view of risk that has led to a clear precedent in favor of deadbands as a way to ensure that normal risk stays with the utility while customers absorb some of the risks of larger magnitude. This precedent is clearly spelled out in dockets UE 137, UE 143, UE 165, UM 995, UM 1008/1009, UM 1071, and UM 1187. CUB/200/Jenks-Brown/16. Even PGE has supported deadbands in several proceedings in recent years. CUB/300/Jenks-Brown/24-26.

#### **B. PGE's Resource Valuation Mechanism (Annual Update)**

In its Opening Brief, PGE comes up with a new argument for maintaining an RVM-like annual update, i.e. that an RVM is necessary in order to maintain an "even allocation" of risk.



The Commission should address this cost-of-service risk in two ways: 1) it should provide for an even allocation of the risk in its forecast of power costs ... The Annual Update relates to the need for an *even allocation of cost-of-service risk* because it is unlikely that the forecast of power costs made in this case will be good for successive years.

UE 180 PGE Op. Br. at 31. Emphasis added.

The goal of an “even allocation” of risk is new to us. It is the utility that has the responsibility (and compensation) to manage risk, so we do not understand the desire to ensure an “even allocation” of risk. We believe the appropriate goal should be to “fairly allocate” risk.

We agree with PGE that costs will change in successive years. However, we believe that those changes in costs are captured and allocated through a PCA. PCAs and RVMs both allocate risks associated with cost changes between general rate cases. One does it on a prospective (forecasted) basis and the other does it on a historic (actual) basis. Staff and CUB have both argued that the regulatory burden of having two annual ratemaking mechanisms, both dealing with power cost variations, is onerous and unnecessary. Staff/800/Galbraith/14; CUB/300/Jenks-Brown/28-29. PGE has offered little real response to our genuine concern.

### **C. Cost-Of-Service Ratemaking**

PGE has claimed that cost-of-service ratemaking requires true-ups to ensure that actual costs flow through to customers and that deadbands proposed by CUB and Staff move away from cost-of-service ratemaking.

PGE is arguing that cost of service rates should accurately reflect the costs of service. Other parties are arguing against that proposition ... the changes in policy and adjustments proposed by other parties that move away from cost-of-service ratemaking...

PGE Op. Br. at 32.

In this case, PGE has tried to redefine cost-of-service ratemaking in a manner that requires the Commission to adopt its proposal for a PCA with no deadband. They even cited SB 1149 in support of this. SB 1149's requirement of cost-of-service rates had nothing to do with whether the costs were forecasted or actual. CUB/300/Jenks-Brown/11-13. CUB has demonstrated that PGE's proposed near-perfect recovery of actual costs is not supported by precedent, shifts the risk of normal variation of costs from the utility to its customers, increases rate volatility and creates inter-generational inequity in rate-setting. CUB/300/Jenks-Brown/14-20.

## **V. Port Westward**

### **A. The Prudence Of Port Westward In Relation To PGE's IRP**

PGE's Opening Brief suggests that the Company is unclear about CUB's recommendation to the Commission on the prudence of Port Westward in this docket.

In particular, CUB expresses concern that PGE does not yet have a signed wind turbine contract for Phase I of its Biglow Canyon wind project and PGE needs Biglow Canyon to complete its IRP action plan ... In PGE's view, it would not be good regulatory policy to withhold a determination of Port Westward's prudence until PGE signs turbine contracts for Biglow Canyon ... The Commission acknowledged PGE's final action plan. It did not acknowledge PGE's final action plan with all actions to be completed at the same time or in a particular order.

PGE Opening Brief at 48-49.

First, PGE overstates our desire to see more certainty with regard to completion of the Action Plan, for CUB made no reference to PGE's contract, or lack thereof, for wind turbines. In addition, no party has suggested that PGE acquire all the resources in its action plan simultaneously or in any particular order.

More to our actual point, however, CUB's concern regarding the prudence of Port Westward, as stated in our Surrebuttal, is as follows:

Though we are not comfortable that the Company's investment in Port Westward is prudent in the context of PGE's actions to implement its Integrated Resource Plan, we cannot yet say that Port Westward is definitely an imprudent investment. The prudence of such an investment will become more clear over time, as PGE does or does not acquire the renewable resources it needs in order to achieve the fuel diversity that is envisioned in its Integrated Resource Plan.

UE 180 CUB/300/Jenks-Brown/31.

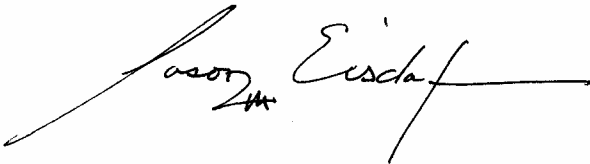
In line with this concern, CUB recommends that the Commission, "[m]ake clear that, if PGE fails to achieve the fuel diversity that was envisioned in the Company's IRP, the prudence of Port Westward should be revisited." CUB Op. Br. at 34. Given CUB's current position on the prudence of Port Westward, our recommendation is not in conflict with PGE's recommendation "that the Commission decide in this case the cost changes associated with Port Westward commencing service." PGE Op. Br. at 48.

CUB accepts that the costs associated with Port Westward are to be determined in this docket. We are not recommending that the Commission not do so. We are recommending, however, given that PGE is mid-stream in the Company's completion of its Action Plan, that the Commission instruct the parties that, should PGE fail to achieve the fuel diversity envisioned in its Action Plan, the prudence of Port Westward should be revisited.

As we stated in our Opening Brief, the Commission acknowledges an IRP Action Plan based on the mix of options that creates the best combination of costs and variance of costs. There is no mix of resources and no best combination if the utility is allowed to build a resource out of context. While we cannot require a utility to build all resources simultaneously, we should also not allow a utility to build only that resource that it really

wants to build, get it comfortably in rate base, and then ignore the rest of the diversifying resources that had been part of the optimal plan. We also saw logistical and policy problems with attempting to impute in the future the past costs of resources that were not built.

Respectfully Submitted,  
December 1, 2006

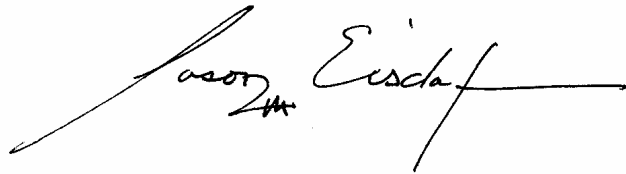
A handwritten signature in black ink, reading "Jason Eisdorfer". The signature is written in a cursive style with a long horizontal stroke extending to the right.

Jason Eisdorfer #92292  
Attorney for the Citizens' Utility Board of Oregon

## CERTIFICATE OF SERVICE

I hereby certify that on this 1<sup>st</sup> day of December, 2006, I served the foregoing Reply Brief of the Citizens' Utility Board of Oregon in docket UE 180 upon each party listed below, by email and U.S. mail, postage prepaid, and upon the Commission by email and by sending 6 copies by U.S. mail, postage prepaid, to the Commission's Salem offices.

Respectfully submitted,



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Jason Eisdorfer #92292  
Attorney for Citizens' Utility Board of Oregon

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JIM DEASON  
ATTORNEY AT LAW

1 SW COLUMBIA ST, SUITE 1600  
PORTLAND OR 97258-2014  
jimdeason@comcast.net

ROBERT VALDEZ

PO BOX 2148  
SALEM OR 97308-2148  
bob.valdez@state.or.us

**AF LEGAL & CONSULTING SERVICES**

ANN L FISHER  
ATTORNEY AT LAW

2005 SW 71ST AVE  
PORTLAND OR 97225-3705  
energlaw@aol.com

**BOEHM KURTZ & LOWRY**

KURT J BOEHM (Q)  
ATTORNEY

36 E SEVENTH ST - STE 1510  
CINCINNATI OH 45202  
kboehm@bkllawfirm.com

MICHAEL L KURTZ (Q)

36 E 7TH ST STE 1510  
CINCINNATI OH 45202-4454  
mkurtz@bkllawfirm.com

**BONNEVILLE POWER ADMINISTRATION**

GEOFFREY M KRONICK LC7 (Q)

PO BOX 3621  
PORTLAND OR 97208-3621  
gmkronick@bpa.gov

CRAIG SMITH

PO BOX 3621--L7  
PORTLAND OR 97208-3621  
cmsmith@bpa.gov

**BRUBAKER & ASSOCIATES, INC.**

JAMES T SELECKY (Q)

1215 FERN RIDGE PKWY, SUITE 208  
ST. LOUIS MO 63141  
jtselecky@consultbai.com

**CABLE HUSTON BENEDICT HAAGENSEN & LLOYD LLP**

TAMARA FAUCETTE

1001 SW 5TH AVE STE 2000  
PORTLAND OR 97204  
tfaucette@chbh.com

CHAD M STOKES

1001 SW 5TH - STE 2000  
PORTLAND OR 97204  
cstokes@chbh.com

**COMMUNITY ACTION DIRECTORS OF OREGON**

JIM ABRAHAMSON (Q)  
COORDINATOR

PO BOX 7964  
SALEM OR 97303-0208  
jim@cado-oregon.org

**CONSTELLATION NEWENERGY INC**

WILLIAM H CHEN  
REGULATORY CONTACT

2175 N CALIFORNIA BLVD STE 300  
WALNUT CREEK CA 94596  
bill.chen@constellation.com

**DANIEL W MEEK ATTORNEY AT LAW**

DANIEL W MEEK  
ATTORNEY AT LAW

10949 SW 4TH AVE  
PORTLAND OR 97219  
dan@meek.net

**DAVISON VAN CLEVE PC**

S BRADLEY VAN CLEVE (Q)

333 SW TAYLOR - STE 400  
PORTLAND OR 97204  
mail@dvclaw.com

**DEPARTMENT OF JUSTICE**

STEPHANIE S ANDRUS (Q)  
ASSISTANT ATTORNEY GENERAL

REGULATED UTILITY & BUSINESS SECTION  
1162 COURT ST NE  
SALEM OR 97301-4096  
stephanie.andrus@state.or.us

**EPCOR MERCHANT & CAPITAL (US) INC**

LORNE WHITTLES  
MGR, PNW MARKETING

1161 W RIVER ST STE 250  
BOISE ID 83702  
lwhittles@epcor.ca

**GRESHAM CITY OF**

DAVID R RIS  
SR. ASST. CITY ATTORNEY

CITY OF GRESHAM  
1333 NW EASTMAN PARKWAY  
GRESHAM OR 97030  
david.ris@ci.gresham.or.us

JOHN HARRIS (Q)  
TRANSPORTATION OPERATIONS SUPERINTENDENT

1333 NW EASTMAN PKWY  
GRESHAM OR 97030  
john.harris@ci.gresham.or.us

**KAFOURY & MCDUGAL**

LINDA K WILLIAMS  
ATTORNEY AT LAW

10266 SW LANCASTER RD  
PORTLAND OR 97219-6305  
linda@lindawilliams.net

**LEAGUE OF OREGON CITIES**

ANDREA FOGUE  
SENIOR STAFF ASSOCIATE

PO BOX 928  
1201 COURT ST NE STE 200  
SALEM OR 97308  
afogue@orcities.org

**MCDOWELL & ASSOCIATES PC**

KATHERINE A MCDOWELL  
ATTORNEY

520 SW SIXTH AVENUE, SUITE 830  
PORTLAND OR 97204  
katherine@mcd-law.com

**W NORTHWEST ECONOMIC RESEARCH INC**

LON L PETERS

607 SE MANCHESTER PLACE  
PORTLAND OR 97202  
lpeters@pacifier.com

**NORTHWEST NATURAL**

ELISA M LARSON (Q)  
ASSOCIATE COUNSEL

220 NW 2ND AVE  
PORTLAND OR 97209  
elisa.larson@nwnatural.com

ALEX MILLER (Q)  
DIRECTOR, REGULATORY AFFAIRS

220 NW SECOND AVE  
PORTLAND OR 97209-3991  
alex.miller@nwnatural.com

**OREGON ENERGY COORDINATORS ASSOCIATION**

KARL HANS TANNER (Q)  
PRESIDENT

2448 W HARVARD BLVD  
ROSEBURG OR 97470  
karl.tanner@ucanap.org

**PACIFICORP**

LAURA BEANE  
MANAGER, REGULATION

825 MULTNOMAH STE 800  
PORTLAND OR 97232-2153  
laura.beane@pacificorp.com

**W PORTLAND CITY OF - OFFICE OF CITY ATTORNEY**

BENJAMIN WALTERS  
DEPUTY CITY ATTORNEY

1221 SW 4TH AVE - RM 430  
PORTLAND OR 97204  
bwalters@ci.portland.or.us

**W PORTLAND CITY OF - OFFICE OF TRANSPORTATION**

RICHARD GRAY  
STRATEGIC PROJECTS MGR/SMIF ADMINISTRATOR

1120 SW 5TH AVE RM 800  
PORTLAND OR 97204  
richard.gray@pdxtrans.org

**W PORTLAND CITY OF ENERGY OFFICE**

DAVID TOOZE  
SENIOR ENERGY SPECIALIST

721 NW 9TH AVE -- SUITE 350  
PORTLAND OR 97209-3447  
dtooze@ci.portland.or.us

**PORTLAND GENERAL ELECTRIC**

RATES & REGULATORY AFFAIRS

RATES & REGULATORY AFFAIRS  
121 SW SALMON ST 1WTC0702  
PORTLAND OR 97204  
pge.opuc.filings@pgn.com

DOUGLAS C TINGEY (Q)

121 SW SALMON 1WTC13  
PORTLAND OR 97204  
doug.tingey@pgn.com

**PRESTON GATES ELLIS LLP**

HARVARD P SPIGAL

222 SW COLUMBIA ST STE 1400  
PORTLAND OR 97201-6632  
hspigal@prestongates.com

**SEMPRA GLOBAL**

THEODORE E ROBERTS

101 ASH ST HQ 13D  
SAN DIEGO CA 92101-3017  
troberts@sempra.com

LINDA WRAZEN

101 ASH ST, HQ8C  
SAN DIEGO CA 92101-3017  
lwrazen@sempraglobal.com

**SMIGEL ANDERSON & SACKS**

SCOTT H DEBROFF

RIVER CHASE OFFICE CENTER  
4431 NORTH FRONT ST  
HARRISBURG PA 17110  
sdebroy@sasllp.com