BEFORE THE PUBLIC UTILITY COMMISSION

OF OREGON

UE 180/ UE 181/ UE 184

In the Matter of PORTLAND GENERAL ELECTRIC COMPANY Request for a General Rate Revision (UE 180),	
In the Matter of PORTLAND GENERAL ELECTRIC COMPANY Annual Adjustments to Schedule 125 (2007 RVM Filing) (UE 181),	**PORTLAND GENERAL ELECTRIC COMPANY'S REPLY BRIEF**
In the Matter of PORTLAND GENERAL ELECTRIC COMPANY Request for a General Rate Revision relating to the Port Westward Plant (UE 184).	

I. INTRODUCTION AND OVERVIEW OF RESPONSE TO PARTIES

Parties to this case have produced extensive evidence for the Commission's consideration. Through five rounds of testimony and exhibits and additional exhibits introduced in lieu of hearings, the record now comprises six separate stipulations, 64 items of testimony from 47 witnesses, and over 350 exhibits. PGE urges the Commission to consider and weigh all the evidence offered as the Commission resolves the remaining contested issues in the case, which are primarily limited to cost of capital, the power cost recovery framework and the level of Net Variable Power Costs ("NVPC").

In contrast to an approach that would encourage consideration of all the available evidence, the other parties' opening briefs ask the Commission unwisely to constrict the evidence available for its consideration. Staff, for example, would remove from the Commission's consideration several sources of relevant and helpful information regarding PGE's required return on equity ("ROE"). Using the Guidelines for Cost of Equity Witnesses ("Guidelines") adopted by the Commission in UE 115 *(Order No. 01-777, Appendix A)* as a form of "exclusionary rule," Staff urges the Commission *not* to consider a multitude of approaches to determining a utility's required ROE.[1] Although this would not seem to be what the Commission intended in adopting the Guidelines, Staff attempts to use the Guidelines to strip away any information that would demonstrate the unreasonableness of its 9.40% ROE recommendation.

Similarly, Staff urges the Commission *not* to consider evidence regarding the power cost recovery frameworks in place for similar electric utilities throughout the country. The evidence on this point includes a comprehensive review of power cost recovery mechanisms conducted by

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[1] The Guideline on "Clarity" states: "All witnesses should clearly and fully explain the methodologies used and the theoretical support for using the methodologies. When advocating a new approach, or one previously rejected by the Commission, a witness should explain why the Commission should adopt the proposed methodology in the present docket." *Order No. 01-777, Appendix A at 1.*

National Economic Research Associates ("NERA"), included in the record as PGE Exhibit 401. Staff has determined that this evidence not only is (1) "not persuasive" to Staff, but that (2) the Commission has not ever found this type of argument to be persuasive. *Staff Amended Opening Brief at 18*. In PGE's view, the Commission determines what is persuasive and what is not, and the Commission should disregard suggestions that it not consider such evidence because one party believes that the Commission would likely not find it persuasive.

ICNU, for its part, urges that the Commission "assign no weight" to a report issued on September 25, 2006 by Standard and Poor's ("S&P") based on ICNU's interpretation – and misinterpretation – of communications between PGE and S&P regarding the contents of the report. *ICNU Opening Brief at 2.* ICNU further advises the Commission that the circumstance "casts doubt on all rating agency reports in the record" (*Id.* at 7), suggesting that these, too, should not be considered, or be considered skeptically, by the Commission as it evaluates the evidence in this proceeding. PGE would not presume to tell the Commission how to do its job in weighing the evidence offered in this proceeding. PGE urges the Commission to consider and evaluate all available and relevant evidence, and to accord the evidence such weight as the Commission deems appropriate under the circumstances. In PGE's view, it would be dangerous to "assign no weight to the S&P report" *(ICNU Opening Brief at 2)* or to "cast[] doubt on all rating agency reports in the record" *(Id. at 7)*, given that PGE's cost of debt will be impacted by the reports of S&P and other rating agencies.

II. COST OF CAPITAL

A. Overview

PGE is requesting an overall rate of return of 8.87%, comprising a required ROE of 10.75%, an equity ratio of 53.3% and a long-term debt rate of 6.73%. *PGE Opening Brief at 4*. In Staff's Opening Brief, it reduces its recommended overall rate of return from 7.86% to 7.80%.

Staff proposes that the Commission arbitrarily reprice the entire $300 million of long-term debt PGE expects to issue in 2007 at a 10-year maturity, rather than using the maturities PGE actually expects to issue ($150 million at 30 years and $150 million at 10 years). Staff proposes that the Commission combine this reduction with an additional disallowance of actual long-term debt costs attributable to a speculative and unsupported "Enron adjustment" and an extremely low 9.40% ROE recommendation. The resulting 7.80% overall rate of return proposed by Staff is 36 basis points lower than recently authorized for PacifiCorp in Docket UE 179 (8.16%) and 50 basis points lower than the 8.30% overall return recommended by ICNU-CUB in this proceeding. *Opening Brief of ICNU at 34*.

The 8.87% overall rate of return requested by PGE is sufficient to ensure confidence in PGE's financial integrity, to allow PGE to maintain its existing credit rating and to attract capital on reasonable terms, all as required by Oregon statute. This is vitally important, given the capital that PGE will be raising in the coming years to support the acquisition of generating resources to provide an economical power supply for our customers over the long term. In contrast, Staff's ROE recommendation, if adopted, would be the lowest authorized ROE in the country. Moreover, Staff's overall return recommendations would push PGE's financial ratios closer to a downgrade, as they would be at the bottom end of S&P's benchmark guidelines for a "BBB+" rated utility.

B. Long-Term Debt

1. The Commission Should Reject Staff's Proposal to Reprice the 2007 Debt Issuances Using Hypothetical, Rather than Actual, Maturities.

As described above, Staff proposes that the Commission use PGE's updated financing plans for 2007 as a basis for a further reduction to PGE's debt costs. The Commission should reject Staff's proposal to re-price the entire $300 million as if it were issued for a 10-year maturity, rather than reflecting PGE's actual plan to issue $150 million for 10 years and $150 million for 30 years. For the reasons stated in PGE's opening brief, the cost of long-term debt the Commission adopts in this case should reflect the type of securities PGE actually intends to issue in 2007. These maturities reasonably match the term of the debt with the useful life of the underlying assets being financed. *PGE/2000, Hager-Valach/13*. Moreover, the 30-year maturity reflects PGE's strategy to stagger the maturity dates of its various bond issuances to ensure that significant amounts of debt do not mature at the same time. *Id*.

Staff also proposes that the Commission use extra-record November 14 data to adopt a rate yet 20-basis points further below the rate supported by evidence in the record. The evidentiary record indicates that PGE's projected coupon rate for the 10-year maturity is 5.77%, comprising a 10-year Treasury rate of 4.77% and PGE's estimated credit spread of 1.00%. *PGE/2700, Hager-Valach/4*. Staff proposed that the Commission use 5.565% on the basis of "a spreadsheet showing the Treasury rate on November 14, 2006" which Staff claims is included as Attachment B to its Opening Brief and which Staff asks the Commission to officially notice pursuant to OAR 860-014-0050. *Staff Opening Brief at 24*. Attachment B, however, is a spreadsheet showing Staff's calculation of PGE's overall weighted cost of long-term debt, and fails to provide any support for using the 5.565% figure. Attachment A appears to be a listing of transactions involving Treasury securities of various maturities and rates, but provides no indication of the source of this information. Nor is there any indication of the source of the 5.565% figure that Staff asks the Commission to "officially notice."

Nothing in OAR 860-014-0050 permits the Commission to take official notice of an attachment that is of unknown origin and which fails to clearly identify the particular figure for which official notice is sought. Staff's reference to Order No. 99-697 in support of its requested abuse of the official notice process is misplaced; in that Order, the Commission on its on motion identified spot rates for U.S. Treasury securities from a particular date of the *Wall Street Journal*. *Order No. 99-697 at 20*. The source and particular figures were identified with particularity, which provided the necessary information that would allow a party an opportunity to make an objection. Staff's attachment of unlabeled sheets of paper with a multitude of unexplained numbers is unfounded and inadequate. The only information in the record for the Commission to use are the figures provided at PGE/2700, Hager-Valach/4, which show a 6.15% rate for a 30-year maturity and a 5.77% rate for a 10-year maturity.

2. Staff Proposes that the Commission Adopt an "Enron Adjustment" Which Assumes, Without Support in the Record, That PGE's Downgrade Is Entirely Attributable to Enron's Ownership.

Staff asks the Commission to find that the only event of significance to PGE's credit rating between 2001 and now is Enron's bankruptcy . According to Staff's Opening Brief, "Staff [sic] analysis looks at the debt costs that would have occurred if PGE had not suffered a rating downgrade due to Enron's ownership." *Staff Amended Opening Brief at 34*. However, Staff's entire 41-basis point debt cost reductions flow from the critical assumption that the one notch downgrading of PGE by S&P would *not* have occurred *at any time during the relevant period* had PGE not been associated with Enron. Staff uses the "A" credit rating that was in place for PGE on November 29, 2001, just prior to Enron's bankruptcy, as the "baseline" for its "Enron-related" adjustments. *Staff/1200, Conway/9*.

Staff claims that its proposed disallowance is “intended to reflect what PGE’s debt costs would have been during the pertinent time period, *absent the Enron impact*, and therefore incorporate the difficult market conditions faced by all utilities during that time.” *Id at 37(emphasis added)*. In fact, however, Staff’s theory assumes that PGE’s downgrade was *solely* attributable to Enron, and disregards other circumstances in the market. Staff made no attempt to perform any analysis to support its claim that its adjustment takes into account, "*absent the*

Enron impact," the widespread decline in creditworthiness suffered by *all* utilities during the 2001 – 2003 period as a result of the deterioration in the financial and wholesale energy markets during the Western energy crisis.

PGE showed that if the Commission views PGE's debt issuances on a portfolio level, PGE's all-in cost of debt for issuances since Fall 2001 compare favorably with market indices for similarly rated utilities. *PGE Ex. 1105; PGE Ex. 2014; PGE/2000, Hager-Valach/10*. Staff dismissed this analysis, stating that "[i]f a student flunks 4th grade, you wouldn't consider them 'successful' based on an analysis that shows their grades were similar to other students who flunked 4th grade." *Staff Amended Opening Brief at 34*. That analogy misses the point, however; in effect, none of the electric utilities in the West received an "A" in the class as a result of the deterioration in the financial and wholesale energy markets during the Western energy crisis. There were 420 downgrade rating actions taken by the three major rating agencies during 2001 and 2002. *PGE Ex. 1104/2*. Staff asks the Commission to take the speculative and unsubstantiated position that PGE is the only one that failed to get an "A" and that PGE would have received an "A" but for its association with Enron. Staff offers no evidence to support such a finding.

Staff cites a number of documents referring to "reduced financial flexibility" during this time period as a basis for its recommendation that the Commission should reduce PGE's long-term debt costs. However, Staff made no connection between this admitted "reduced financial flexibility" and the long-term debt costs that Staff is asking the Commission to reduce in this case. Both references to Commission orders cited by Staff are to proposed debt issuances to secure PGE's *short-term debt*. Staff cites the requested authority in June 2002 to issue up to $300 million of First Mortgage Bonds "to secure the Company's short term revolving credit facilities." *Staff Amended Opening Brief at 38, citing Order No. 02-384, App. A at 2*. Staff notes that PGE asked the Commission to modify the restrictions on the interest rate because "it did not have access to the commercial paper market." *Staff Amended Opening Brief at 38, citing Order No. 02-444, App. A at 2.* Staff also cites to Order No. 02-477, which refers to "interest rate spreads [that] appear generally high" for First Mortgage Bonds *that were not issued at the time*. *Staff Amended Opening Brief at 39.* Finally, Staff cites an excerpt from PGE's March 17, 2003 10-K Report, which refers to "PGE's reduced financial flexibility" due to a number of circumstances, including the "difficult capital market environment." *Id.*

There is no question that PGE had "reduced financial flexibility" during the 2001-2003 time period, and that its access to the credit markets was restricted at times. However, the evidence that Staff urges the Commission to rely upon relates to *short-term* issuances; Staff has not and cannot connect this evidence to the debt costs actually incurred by PGE for long-term debt issued between October 28, 2002 and August 4, 2003 that Staff would have the Commission "re-price." *Staff Opening Brief at 32*. Assembling a series of excerpts from Commission orders and similar documents does not substitute for the analysis necessary to establish a firm evidentiary basis for the large reduction – 41 basis points – that Staff is urging the Commission to make to PGE's actual debt costs.

C. Capital Structure

1. Using the Equity Ratio from Staff's Comparable Company Group Would Ignore PGE-Specific Circumstances, Such as the Debt Equivalence Analysis Arising from PGE's Reliance on Purchased Power.

Staff recommends that the Commission set PGE's capital structure for ratemaking purposes as if PGE had a capital structure of 50 percent common equity and 50 percent debt, rather than PGE's actual projected capital structure (53.3% equity, 46.7% debt). Although Staff claims this hypothetical capital structure "mirrors the common equity ratio of the companies in Staff's sample group" *(Staff Opening Brief at 43),* this statement is unsupported by the record.[2]

Accepting Staff's claim that its equity ratio recommendation is based solely on the equity ratio from Staff's sample group of companies, Staff argues that the Commission cannot use PGE's actual equity ratio without "overcompensating" PGE. This argument ignores a critical point, however: Only *if all else is equal* is it true that the cost of equity drops as the percentage of common equity in the capital structure increases. That is what the Commission found in Docket UE 115, Order No. 01-777 at page 36.

In selecting a capital structure to use in ratesetting for PGE, the Commission must also consider the need to compensate for the "debt imputation" or debt equivalent analysis that S&P performs to address the risks associated with long-term power purchase agreements. *PGE/1100, Hager-Valach/44*. The amount of imputed debt from long-term purchased power contracts and operating leases in 2007 is projected to be approximately $250 million, which adds about 5.6% of additional debt to PGE's balance sheet. *PGE/2000, Hager-Valach/29*. ICNU-CUB acknowledge that the impact of adjusting the debt ratio to reflect off-balance sheet debt equivalence – under the analysis performed by S&P – would increase PGE's total adjusted debt ratio to 55%. *ICNU-CUB/300, Gorman/10*. The approach advocated by Staff disregards this debt equivalent analysis, and pretends that PGE's reliance on purchased power is the same as that for all of the other companies in Staff's sample group. Staff performed no analysis to compare PGE's reliance on purchased power to that of the other companies in its sample group, even

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[2] Staff initially proposed an equity ratio of 48.5%, based exclusively on the average equity ratio from the sample group of companies relied upon by Staff for its ROE recommendation. *Staff/1000, Morgan/5*. In its sur-rebuttal testimony, Staff revised its equity ratio recommendation upward to 50%, without any explanation. *Staff/1400, Morgan/52*.

though the information that would have permitted such analysis was readily available. *Morgan Deposition, Exhibit PGE/3102 at 35-36.*

Moreover, the approach Staff advocates disregards that PGE's construction program and associated financing needs are substantially higher than those of the reference group companies. PGE requires a higher equity ratio than the sample group to provide it with the ability to raise capital on reasonable terms to fund the capital expenditures PGE will soon be making, including the first phase development of 126 MW of wind generation. *PGE/2700, Hager-Valach/3*. In addition, PGE faces hydro relicensing investment for its Deschutes, Clackamas and Willamette River plants and environmental costs at Boardman. *Id at 11*. PGE is also required to maintain liquidity for unexpected margin calls as wholesale power prices fluctuate as well as for unresolved issues, including litigation and the impact of SB 408. *Id.*

2. Other Arguments Staff and ICNU Offer Cannot Support the Commission Adopting a Hypothetical Capital Structure with a 50% Equity Ratio for Setting PGE's Rates.

Staff and ICNU would have the Commission adopt a hypothetical capital structure for PGE based on certain documents referring to a "target" debt ratio of 50% for 2007. Based on these documents, they claim that their recommended capital structures will align with PGE's actual capital structure for 2007. *Staff Opening Brief at 45; ICNU Opening Brief at 38-39*. The presentation cited by Staff and ICNU makes clear, however, that PGE would achieve a 50% equity ratio for 2007 *only if* PGE finances the entirety of advanced metering infrastructure ("AMI") and the Biglow Canyon wind project are financed *entirely* in 2007. *PGE/2700, Hager-Valach/10*. The document is consistent with PGE's position in this proceeding because PGE will not be completely financing AMI in 2007.

ICNU also claims that its recommended 50% equity ratio is consistent with comparable utilities' capital structures, citing in particular the proceedings involving three Northwest utilities, PacifiCorp, Puget Sound Energy ("PSE"), and Avista. *ICNU Opening Brief at 38*.

The stipulated 50% equity ratio adopted for PacifiCorp in Docket UE 179 cannot be cited as precedent "for resolving issues in any other proceeding," according to the terms of the Stipulation executed by ICNU in that docket. *Docket UE 179, Order No. 06-530, Appendix A at 9*. That stipulated capital structure also included a component for preferred stock, which is inapplicable to PGE. *Id. at 6*.

The 45% equity ratio that PSE is seeking in Washington Utilities and Transportation Commission ("WUTC") Docket No. UE-060266 represents PSE's actual equity ratio for 2007. This supports PGE's argument in this docket that rates should be set on the basis of the utility's actual equity ratio. The WUTC's practice is to reflect the reasonable levels of equity projected to be invested in the utility throughout the rate year. As stated by the WUTC in PSE's 2004 general rate case:

> Our goal in this proceeding should be to set the Company's equity ratio at the level that the evidence shows is most likely to prevail, on average, over the course of the rate year.

WUTC v. Puget Sound Energy, Order No. 06 at ¶ 40, Docket Nos. UG-040640, et al. (2005). If the Commission wishes to look to the practice followed in Washington with respect to PSE, as suggested by ICNU, then it should adopt PGE's actual equity ratio of 53% for this proceeding.

Finally, the Avista precedent cited by ICNU illustrates the situation where the WUTC departs from using a utility's actual equity ratio: when a higher-than-actual equity ratio is necessary to strengthen a utility's balance sheet. In Docket No. UE-050482, the WUTC approved the use of a 40% equity ratio rather than Avista's actual utility equity capitalization of 27% in order "to support the Company's continuing efforts to strengthen its balance sheet and restore its credit rating to investment grade" which, according to the WUTC, was "an important goal recognized by all parties except for ICNU." *WUTC v. Avista, Order No. 05 at ¶ 55, Docket Nos. UG-050482, et al. (2006)*. The precedent thus stands for the proposition that a higher-than-actual equity ratio may be necessary for financial integrity purposes. This runs completely counter to ICNU's position in this proceeding that the Commission should use a lower-than-actual equity ratio. Based on the principle expressed by the WUTC in the *Avista* case, the implied recommendation of Staff's and ICNU's recommendation is to weaken PGE's balance sheet and thereby undermine its financial integrity.

D. Return on Equity

1. DCF Analysis

a. Commission Consideration of Utility-Specific Risks Is Not a "New Approach" in Setting a Required ROE.

Staff claims that the Commission has not previously made adjustments to a utility's required ROE based on utility-specific risks, and that the Guidelines require to explain why the Commission should adopt this "new approach." *Staff Initial Brief at 39*. Staff further argues that PGE failed to offer "persuasive evidence" demonstrating the effects of PGE-specific risks.

As described above, the Guidelines provide that "[w]hen advocating a new approach, or one previously rejected by the Commission, a witness should explain why the Commission should adopt the proposed methodology in the present docket." *Appendix A, Order No. 01-777*. It is not a "new approach" to suggest that an ROE analysis must look beyond the return suggested by a DCF analysis of a sample group of companies to consider whether that sample group adequately captures the risks, and return requirements, of the subject utility. Rather, that is precisely what is required by ORS 756.040(1)(a) and the constitutional requirement from *Bluefield Waterworks & Imp. Co. v. West Virginia Public Service Commission*, 262 U.S. 679

(1923) ("*Bluefield*"), which provides that "[a] public utility is entitled to such rates as will permit it to earn a return on the value of the property which it employs for the convenience of the public equal to that generally being made at the same time and in the same general part of the country *on investments in other business undertakings which are attended by corresponding risks and uncertainties . . . .*" *262 U.S. at 692-93 (emphasis added)*. Following its DCF analysis of its sample group of companies, Staff made no attempt to identify or adjust for differences between the sample group's risks and PGE-specific risks. *PGE/2000, Hager-Valach/41-43*.

Throughout these proceedings, PGE has identified these risks, including the risks associated with heavy dependence on purchased power (including the historic Mid-Columbia contracts), the absence of a power cost recovery mechanism, the perceived negative regulatory environment as a result of the enactment of SB 408, and PGE's lack of jurisdictional diversity, being located entirely within Oregon. *Id.* Staff justifies its failure to address PGE-specific risks on the basis of its understanding of the Modern Portfolio Theory which, according to Staff, means that the risks associated with investing in PGE need not be compensated if they can simply be diversified away. *Staff/1003, Morgan/32-33*. Staff offered no analysis to demonstrate which of PGE's risks investors could diversify away, and which they could not. *PGE/2000, Hager-Valach/43-44*. For example, it is difficult to envision an ability to diversify away the "double whammy effect" of SB 408's implementation.[3] Should the Commission adopt this misapplication of the Modern Portfolio Theory, the ROE it allows PGE will not meet the statutory and constitutional standards because it will not adequately compensate investors for the *risks of investing in PGE*. *PGE/2000, Hager-Valach/43-44*.

[3] Docket AR 499, Order No. 06-532 at 10-11.

Rather than providing details on how investors can diversify away these PGE-specific risks, Staff claims that the issue of utility-specific risks is a "new approach" that PGE must justify under the Guidelines. This concept has not been a "new approach" since 1923, when the U.S. Supreme Court rendered its decision in *Bluefield*.

ICNU, for its part, claims that "all objective indications" show that PGE is not more risky than the companies in the sample group used by ICNU-CUB witness Gorman. *ICNU Opening Brief at 47, 51-53*. The evidence cited on this point, however, consists primarily of the criteria Mr. Gorman uses to narrow his proxy group of comparable utilities to companies with S&P business risk profile scores between three and six and with bond ratings in the "BBB," "Baa," and "A" categories. *ICNU-CUB/300, Gorman/15*. PGE agrees that these are useful measures in selecting a proxy group of comparable companies. *PGE/2700, Hager-Valach/6*. But no sample group of companies fully reflects all of PGE's potential risks, growth, and related characteristics. *PGE/2000, Hager-Valach/66.*

PGE identified several PGE-specific risks that are not reflected in either Staff's or ICNU-CUB's sample group of companies, and considered these risks in addition to the results produced by PGE's model to determine an appropriate range for PGE's required ROE. *PGE/1100, Hager-Valach/39*. These PGE-specific risks include the absence of a power cost recovery mechanism, PGE's heavier reliance on hydroelectric generation and purchased power (which in turn translates to high NVPC variability in relation to generation rate base), the uncertainties and negative perceptions associated with operating under SB 408, and risks associated with potential municipal and/or judicial ratemaking. *PGE/2000, Hager-Valach/41-43*. Many of these risks are "unique" to PGE, such as 100% exposure to the impacts of SB 408 (unlike NW Natural and PacifiCorp) and being the focus of the municipal ratemaking efforts. ICNU cites the following standard from the WUTC regarding the showing necessary to support the exercise of judgment in cost of capital testimony:

> While the determination of the cost of common-equity capital requires the exercise of judgment, the use of judgment must be informed by the facts. If meeting the burden of proof through opinion testimony has any meaning, it means that the witness must present a logical connection between the factual evidence presented and the opinion offered. *WUTC v. Avista, Docket Nos. UE-991606 and UG-991607, Order No. 03 at ¶ 355 (2000)*.

ICNU Opening Brief at 52. That is precisely the demonstration that PGE has made in this proceeding: The factual evidence regarding PGE's particular characteristics supports the opinion offered by PGE ROE witnesses that within the range of 9.25% to 11.3%, a point estimate of 10.75% is reasonable. *PGE/1100, Hager-Valach/39*.

b. Staff Is Misapplying the Guidelines to Preclude the Commission's Consideration of Helpful and Relevant Information.

Staff's Opening Brief includes several references to the Guidelines as the basis for precluding consideration by the Commission of evidence relating to the determination of PGE's required ROE. As noted above, Staff claims that it is inconsistent with the Guidelines for PGE to suggest that the Commission must consider utility-specific risks when setting an ROE, on the basis that this is a "new approach." *Staff Opening Brief at 39*. Staff claims that the Commission should not consider the results produced by PGE's risk positioning model ("RPM") on the grounds that the Guidelines preclude it in the absence of an explanation by PGE as to "why the Commission should use the model results as the basis of a [required ROE] estimate." *Id*. Staff also urges the rejection of any dividend yield calculation using anything other than the one-day spot price, once again claiming that this exclusion is required by the Guidelines.[4] *Id. at 49*.

[4] At the same time, however, Staff relies heavily on its "leveraged beta" analysis in an attempt to show that its extremely low 9.40% ROE recommendation is not really out of line with the ROE decisions of other commissions, which averaged 10.47% since January 2005. This "leveraged beta" analysis, of course, is nothing more than a

Staff's recommended use of the Guidelines as an exclusionary cudgel would mean that the Commission must disregard relevant and helpful information in determining the required ROE for PGE. This limited view is consistent with Staff's ROE analysis, which relies on only three versions of the DCF model to support an extreme recommendation – an allowed ROE for PGE of only 9.40%. In sharp contrast to Staff's narrow approach, PGE and ICNU-CUB offered ROE analyses that take into account the wealth of information available to estimate PGE's required ROE. The Commission should reject Staff's argument that the Guidelines preclude the Commission's consideration of this wealth of information.

c. Staff's Proposals Are Out of Line with Other Commission Decisions.

PGE Exhibit 2706 shows the ROEs adopted by regulatory commissions throughout the country over the past 18 months; it shows that the average ROE allowed for electric or combination utilities since January 2005 is 10.47%, or over 100 basis points greater than that recommended by Staff. Staff claims that it considered the results from other commission decisions, and that these results show "Staff's proposals are not out of line with other commission decisions." *Staff Amended Opening Brief at 50*. In support of this statement, Staff cites its "leveraged beta" analysis and its "limited selection" of 16 regulatory decisions in 2004 and 2005. *Staff/1400, Morgan/13-14*. This analysis fails utterly to support the point urged by Staff.

First, Staff's analysis relies upon the CAPM which, as noted above, the Commission abandoned in Docket UE 115 as not providing "supportable and reasonable results." *Order No. 01-777 at 32*. Second, Staff used an assumed "beta" of 0.85 without explaining how it generated that figure. *PGE/2700, Hager-Valach/12*. Third, Staff provided no explanation as to

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primitive application of the Capital Asset Pricing Model ("CAPM") that the Commission firmly rejected in Docket UE 115 as not providing "supportable and reasonable results." *Order No. 01-777 at 32*. Staff itself fails to comply with the Guidelines when it offers a CAPM-based analysis "previously rejected by the Commission" without an explanation "why the Commission should adopt the proposed methodology in the present docket." *Order No. 01-777 at App. A*.

how it made its "limited" selection of 16 particular regulatory decisions out of the 42 decisions that were available. Finally, Staff purportedly used a "range of adjustments for decreased leverage identified in Order No. 01-777 (UE 115)," but Staff (1) did not update the information and (2) used the absolute bottom of the range (*i.e.*, 4 basis points for each one percent increase in the level of common equity in the capital structure) rather than the top (13.8 basis points) or even the midpoint (8.7 basis points). *PGE/2700, Hager-Valach/11.* Using either the midpoint or the top of the range would have produced ROE figures so low as to utterly lack credibility. *Id.* Staff's analysis does nothing to refute the evidence that its ROE recommendation of 9.40% is far below that granted by any regulatory commission in the country, and is so extreme as to strip it of any credibility.

2. Risk-Positioning Model

a. Commission Consideration of PGE's Risk Positioning Model Comports Fully with the Guidelines the Commission Adopted in Docket UE 115.

Staff claims that the risk positioning model ("RPM") used by PGE as a basis for its required ROE estimate was "previously rejected" by the Commission (in Docket UE 115), and that the Guidelines require PGE to demonstrate why the Commission should nonetheless consider the RPM as it determines ROE in this proceeding. *Staff Initial Brief at 52-53; Appendix A, Order No. 01-777.*

In Docket UE 115, the Commission "declined to adopt" PGE's RPM for use in that proceeding on the basis that it found the approach to be "unconventional" and not yet "accepted by regulatory agencies as a reliable means for determining cost of equity." *Order No. 01-777 at 33*. PGE's testimony in this proceeding addresses these observations about the RPM approach. PGE's direct testimony explains that a risk positioning model "has been used in several jurisdictions, including FERC and Texas." *PGE/2000, Hager/Valach/52*. *Sierra Pacific Power*

Company, Docket No. 05-10005 *et. al*, 248 PUR 4^{th} 364*,* decided by the Nevada PUC in April 2006, is a recent example of a case using an RPM-type approach. In that proceeding, Dr. Roger Morin performed three Risk Premium analyses, including one based on the risk premiums implied in the ROEs allowed by regulatory commissions for electric utilities over the last decade relative to the contemporaneous level of the long-term Treasury bond yield. *Order, ¶ 49*. In its ROE discussion, the Nevada PUC stated that its practice was to rely on the results of DCF models "to provide a baseline from which to set the ROE," but that it also relied on other models "as a useful check on the reasonableness of the DCF model." *Id. at ¶ 119*. In arriving at an ROE of 10.6% for Sierra Pacific, the PUC stated that it "continues to believe that the DCF is an appropriate methodology for setting a baseline ROE," but that "incorporating the results from other methods in selecting a rate has benefits." *Id. at ¶ 120.* It rejected an argument that the DCF methodology should be relied upon exclusively, finding that the record shows that "the DCF results are *at the low end of range of recommendations for each witness, and thus other methods should be used to adjust the rate up from the DCF results*." *Id. (emphasis added)*.

PGE Exhibit 2011 is a survey of the ROE approaches used by commissions throughout the country, and demonstrates the widespread use of various forms of the Risk Premium approach. PGE's outside cost of capital witness, Dr. Zepp, has participated in numerous electric and water utility cases in which he, consumer advocates, and/or other parties presented variations of the model. *Id*. PacifiCorp's cost of capital witness, Dr. Sam Hadaway, presented a risk premium model very similar to PGE's RPM in Docket UE 179, and examined the relationship between Moody's average public utility bond yield and authorized electric returns for the years 1980-2005. *Docket UE 179, Exhibit PPL/206, Hadaway/1*. In this proceeding, ICNU-CUB witness Gorman presented a Risk Premium Model that produced very similar results to those suggested by PGE's RPM analysis. Mr. Gorman estimated the risk premium on the basis of regulatory commission-authorized returns for electric companies over the period 1986 through June 2006. *ICNU-CUB/300, Gorman/21*. This risk premium analysis produced an average return estimate of 10.4%. *Id. at 23.*

In a manner consistent with the Guidelines, PGE's evidence demonstrates why the Commission should consider PGE's RPM in this case. The risk premium approach reflected in PGE's RPM provides a good parallel approach to the DCF model, and provides some assurance that current market conditions are accurately reflected in the cost of equity estimate.

b. PGE's Risk Positioning Method Has a Sound Theoretical Foundation and Has Been Subjected to the Necessary Statistical Analyses.

Staff makes a number of arguments about claimed theoretical and statistical flaws in about PGE's Risk Positioning Model. *Staff Amended Opening Brief at 56-60*. Staff's claim that the model "is flawed from a regulatory perspective" *(Id. at 56)* evinces Staff's misunderstanding of the model. PGE is not suggesting that ROE decisions from other commissions be used *directly* to determine a utility's ROE. Rather, the model measures the relationship between interest rates and ROEs over time which, in turn, suggests a spread that is applied to expected market interest rates. *PGE/1100, Hager-Valach/30*. The model has a sound theoretical underpinning: PGE established a hypothesis regarding interest rates and authorized ROEs, tested its hypothesis, and verified its results. Once PGE determined that interest rates were the most important variable, PGE limited its analysis to that variable. Staff's critique of the Risk Positioning Model attempts to obscure the basic point that the model provides useful information by relying on irrelevant, statistical arguments. *PGE/2800, Zepp/1*. Staff continues to base its arguments on PGE not performing certain statistical tests – for heteroskedasticity and autocorrelation – on the data. *Staff Amended Opening Brief at 59*. PGE explained that such tests are unnecessary given the nature of the data used in the analysis. *PGE/2000, Hager–Valach/61-*

62. The data set does lend itself to the standard statistical tests that one would expect when using an ordinary least squares regression, and PGE described these tests and the results produced by this testing. *Id. at 62-63*.

Staff's argument that the model is "unconventional" also is unfounded. Whether or not a model is "conventional" should not be determined by Staff's familiarity (or lack thereof) with it. As described above, Risk Premium or Risk Positioning models in one form or another are used by several cost of capital witnesses and in several jurisdictions. The Commission should find the results to be useful information.

c. PGE's Use of Seven-Year Treasury Bonds In Its RPM Analysis Is Reasonable.

ICNU claims that PGE's use of a seven-year Treasury bond for PGE's RPM analysis was "inappropriate and unreasonable." *ICNU Opening Brief at 50*. According to ICNU, the seven-year security "is not a reasonable interest rate proxy to use to estimate an equity risk premium" because it "reflects the short-term market forces" which results in "significant volatility." *Id*. This argument is without merit. Although ICNU claims that seven-year Treasuries are too short for a long-term equity analysis, ICNU-CUB witness Gorman uses *five*-year Treasury yields to assess the reasonableness of his DCF growth analysis. *PGE/2000, Hager-Valach/70*. It is unclear why five years is acceptable for a long-term equity analysis in ICNU's view, but seven years is too short. In any event, using 10-year Treasuries does not change the outcome of the RPM analysis materially; the implied ROEs would fall by approximately 15 basis points. *Id*. The results drop by 40-45 basis points if 30-year Treasuries are used. *Id*. Thus, even using these longer-term Treasuries, the results are still in the 10.7% to 11.2% range.

III. POWER COSTS

A. Power Cost Recovery Framework

1. Overview

a. PGE Is Proposing Two Tariff Mechanisms That Would Align Cost of Service Prices More Closely with the Prudently Incurred Cost of Providing Electric Service.

Power costs, in total, represent about two thirds of PGE's revenue requirement; NVPC alone represents over one half of PGE's revenue requirement. The regulatory framework adopted in this proceeding must provide PGE with both the ability to recover its costs and a reasonable opportunity to earn its allowed return. Given PGE's relatively small rate base, it does not have an earnings margin sufficient to bear significant shortfalls in power cost recovery. PGE is proposing a power cost recovery framework that reduces the risk of variations in power costs for both PGE and its customers, while preserving PGE's incentive to control actual power costs through a sharing percentage.

Of the two tariff mechanisms proposed by PGE in this proceeding, the other parties oppose one of these mechanisms (the Annual Update Tariff) in its entirety, and seek limitations on the other (the Variance Mechanism Tariff) that would insure a gap between prices and the costs of service. Other parties argue against the proposition advanced by PGE that rates should accurately reflect the costs of service. Staff openly states that customers are better off if rates are not allowed to reflect cost of service: According to Staff, "[t]his is because: (i) customers likely assign more weight to the avoidance of rate increases then [sic] they do to the pursuit of rate decreases, and (ii) *PGE's exposure to higher NVPC is greater than its exposure to lesser NVPC*." *Staff Amended Opening Brief at 15-16*. If Staff is correct that it is more likely that PGE will under-recover its power costs than over-recover, PGE does not have a reasonable expectation of earning its authorized ROE. Staff seeks to preserve this inequity by inclusion of a large deadband in any PCA mechanism. CUB also proposes to include an asymmetrical deadband within the PCA mechanism that exacerbates the problem.

In general, Staff and intervenors appear to argue that cost of service ratemaking need not actually reflect costs that are difficult to forecast. For such costs, a hypothetical estimate is good enough. Or, as CUB puts it, PGE should be a shock-absorber. ("[I]t is the utility's responsibility to absorb a certain level of power cost variation, for better and for worse . . . ." *CUB Opening Brief at 7*.) These parties would require PGE to deliver on-demand electric service at a price set in advance without knowing what the actual costs will be. With the very small percentage of revenues (7%) to cover PGE's proposed equity return requirements, this is not enough to be much of a shock absorber for customers. Further, the proposals for capital structure and ROE put forth by CUB, ICNU and Staff in this docket would only further erode this cushion to absorb variability of other costs.

ICNU, for its part, opposes any mechanism whatsoever, claiming that PGE's proposed power cost recovery framework fails to comply with Commission's policy objectives. *ICNU Opening Brief at 6*. Rather than having the Commission consider alternatives offered by Staff and CUB that may, in ICNU's view, comply with such objectives, ICNU recommends that no power cost framework of any type (other than frequent general rate cases) be implemented. *Id*. ICNU spends a considerable portion of its Opening Brief creating a sideshow issue regarding PGE's communications with S&P and, in doing so, levels serious accusations against both PGE and S&P that are unsupported by the record. Among other things, ICNU alleges that PGE engaged in "manipulation of evidence" (*ICNU Opening Brief at 12*), attempted to "create evidence" (*Id. at 9-10*), "fundamentally altered S&P's report" (*Id*. at 11), and "directly influence[d] rating agency statements about the Company." *Id. at 2*.

These allegations are disturbing in three respects. First, they are based on a mischaracterization of the evidence provided in Exhibit ICNU/412. As discussed more fully in PGE's response to ICNU's separate but related Motion to exclude that exhibit from the protective order,[5] PGE did not "create" or "manipulate" evidence. PGE did not create the "entire new paragraph" that was added between the first draft of the report and the second *(ICNU Opening Brief at 8)*; that discussion was added by S&P, as is apparent from reviewing the complete string of communications between S&P and PGE provided in the initial and supplemental response to ICNU data request number 232, included as Exhibit ICNU/412. In its claims regarding "creation" and "manipulation" of evidence, ICNU vastly overstates PGE's ability to "directly influence" what S&P includes in its reports about PGE.

Second, the "revelation" cited by ICNU with respect to PGE's interaction with rating agencies is, in fact, nothing out of the ordinary. It should be no surprise to anyone that S&P would request facts and views from rated companies. S&P's website clearly explains this; Section 3.7 of the Code of Conduct on the S&P website anticipates that "issuers" such as PGE will have the opportunity to correct factual or other matters in order to produce a credible rating, and that S&P will "duly evaluate the [issuers'] response." ICNU acknowledges in its Motion that "[t]he fact that S&P and PGE communicate about the Company is not confidential" and that "PGE officials have publicly stated that such communications occur." *Motion at 5*. S&P strives for accuracy, which requires a broad gathering of information from many sources and much double-checking. That broad inquiry and double-checking does not mean that the views ultimately expressed are not S&P's own.

[5] ICNU Motion to Exclude Exhibit ICNU/412 from the Protective Order, filed November 20, 2006.

Third, ICNU creates the misimpression that, but for the statement in the S&P Report, PGE would not be making claims about the need for a comprehensive power cost regulatory framework. *See references to PGE/2400, Lesh/16, ICNU Opening Brief at 7.* PGE has been telling the rating agencies the same message that PGE is telling the Commission and the parties in this case: (1) PGE fundamentally disagrees with any suggestion that the UM 995 framework should apply to PGE's NVPC recovery, (2) PGE disagrees with aspects of the Commission's guidance in UE 165, and (3) while hydro risk is large, it is not the only cost of service risk associated with forecasting NVPC. It should be no surprise that S&P would perceive a link between the regulatory framework applicable to PGE's ability to recover over 50% of the costs it must prudently incur to serve customers. That regulatory framework directly affects PGE's cash flows and the ability to support debt, *i.e.*, the weaker the framework, the weaker the credit. These issues are discussed thoroughly in PGE's testimony at PGE/1800, Lesh/8-32 and PGE/2400, Lesh/13-26. It is quite unremarkable that S&P, with its familiarity with PGE's operating characteristics and risks, would make the same observations as PGE is articulating in this case.

It would be dangerous to "assign no weight to the S&P report" *(ICNU Opening Brief at 2)* or to "cast[] doubt on all rating agency reports in the record" (*Id.* at 7), as ICNU suggests, given that PGE's cost of debt will be impacted by the reports of S&P and other rating agencies.

2. Annual Update Tariff

For the most part, the parties' Opening Briefs offer nothing new in opposition to PGE's proposed Annual Update Tariff. In a variation on Staff's theme that it is appropriate for PGE to bear the risks of power cost variations because they are more likely to be higher than lower, ICNU cites the large reduction in power costs in the 2003 RVM, and claims that this does not justify the Annual Update Tariff "because there is no similar expectation of a substantial power cost decrease." *ICNU Opening Brief at 23*. In other words, ICNU could support an annual update only if it knew that power costs were going down and, since they are not, PGE should bear the risk of any shortfall.

ICNU claims that the NERA Report does not support the annual update tariff as no other utilities have such a mechanism. *Id. at 23-24*. In fact, Table 2 on page 17 of the Report shows the frequency with which utilities in each state can adjust their rates based on updated fuel and purchased power costs. Many states have "automatic" PCAs in which the utility can recover its costs with little or no lag time.[6] *PGE/401, Lesh-Niman/21*. The NERA Report thus supports the use of a mechanism such as the Annual Update Tariff that will permit a timely updating of power costs and minimize monthly deferrals.

CUB, for its part, claims that an annual update is made unnecessary by a PCA mechanism. *CUB Opening Brief at 7*. PGE disagrees; use of the annual update achieves different objectives than the Variance Mechanism Tariff, such as (1) ensuring that PGE's cost of service prices reflect the costs actually incurred by PGE for power supplies to serve customers over a given year (*PGE/1800, Lesh/33)*, and (2) helping the Commission maintain the allocation of NVPC risk it has chosen in creating the test year forecast. *Id*. Moreover, the Annual Update Tariff recognizes that the greater volatility on NVPC cost-of-service risk is year-to-year, and not within the year. *PGE/1800, Lesh/4*.

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[6] For many, the automatic nature of updating the forecast is a question only of customer rates and utility cash flow because any actual cost variation goes into a balancing account with no sharing or deadband.

3. Variance Mechanism Tariff

a. The NERA Report Provides Valuable Evidence Regarding the Types of Power Cost Recovery Mechanisms in Place Throughout the Country, and Should Be Considered by the Commission.

Staff claims it is "not persuasive" for PGE to claim that a deadband is a significant departure from how other states regulate utilities comparable to PGE. *Staff Amended Opening Brief at 18.* Staff further states that this is not "the type of argument this Commission has ever found to be persuasive." *Id.* Staff's argument on this point creates the impression that the only evidence cited by PGE on this point is the September 25, 2006 S&P Research Report. *Id.* This mischaracterizes the evidentiary record, and disregards the substantial information offered by PGE regarding the common elements of power cost recovery mechanisms followed by the majority of other states. PGE offered a comprehensive report prepared by NERA which showed that deadband/sharing mechanisms are rarely used *(PGE/401, Lesh-Niman/33-34*), and that 100% of coverage of differences between forecasted and actual NVPC was a common regulatory practice. *PGE/2400, Lesh/15*. The power cost recovery framework PGE proposes is most like those used for similar, vertically integrated electric utilities. Adoption of a deadband for PGE, on the other hand, would continue the current significant difference between PGE's regulatory environment and that of other, comparable, electric utilities. This bears directly on how the national financial markets evaluate Oregon's regulatory climate which, in turn, affects the perceived riskiness and creditworthiness of PGE. *Id. at 15-16.*

It is indeed odd that Staff would ask that the Commission not consider this evidence for the reasons that (1) Staff does not find it to be persuasive, and (2) Staff presumes that the Commission will not find it to be persuasive. *Staff Amended Opening Brief at 18*. It is for the Commission to decide what is persuasive. What the NERA and S&P Reports provide are facts regarding what other states do, and the role that power cost recovery plays in evaluating a utility's creditworthiness. Excluding consideration of the evidence does not change the fact that PGE's proposed power cost framework is consistent with the power cost frameworks of most utilities in the country; Staff's and the intervenors' are not. Rather than proposing to narrow the range of evidence that the Commission should consider, Staff should address that evidence by reconciling its PCA proposal with the findings of the NERA Report.

b. Staff Acknowledges That Different Deadband Recommendations May Be Appropriate to Accommodate the Characteristics of Particular Utilities.

In Staff's view, the purpose of a deadband is "to exclude a reasonable range of normal variation in power costs from triggering the PCA mechanism." *Staff Amended Opening Brief at 21*. Staff acknowledges that this standard "may result in different deadband recommendations for the different electric utilities." *Id*. For all the reasons stated at pages 35-39 of PGE's Initial Brief, PGE submits that, taking its circumstances into account, a deadband is neither necessary nor appropriate for PGE. On the other hand, if the Commission determines that a deadband is necessary, PGE agrees with Staff's view that different deadband recommendations may be necessary to accommodate the different circumstances of each electric utility.

With that view in mind, PGE offered a number of parameters that the Commission should take into account in designing a deadband, including (1) the utility's generation rate base, (2) limiting the NVPC variance deadband to a portion of the risk premium (over the market cost of debt) associated with generating investment, (3) considering the combined effect of the deadband and sharing percentages in determining the fairness of the mechanism, and (4) adjusting the risk sharing percentages to reflect the "double whammy effect" of SB 408 implementation. *PGE/2400, Lesh/22*.

Staff claims that its recommended deadband is based on professional judgment, and cites UM 995 in particular as the source of this professional judgment. *Staff Amended Opening Brief* *at 22*. It is difficult to reconcile Staff's acknowledgement that different deadbands may be appropriate for different utilities with Staff's reliance on UM 995 as the source of its "professional judgment." UM 995 involved circumstances far different than those present here, including (1) adoption of a deferral mechanism rather than an ongoing power cost recovery framework, (2) adoption of such a mechanism to take account of the circumstances at the time – during the Western energy crisis – when power costs were *known* to be substantially higher (*i.e*., no need to design a sharing percentage that would be appropriate for sharing lower power costs with customers), and (3) the utility for which the mechanism was designed, PacifiCorp, which has substantial owned generation (*i.e*., its generation rate base far more substantial than PGE's) and which is a multi-jurisdictional company that creates "a unique situation regarding the company's request for any recovery of increased costs" given the need to "isolate Oregon customers from load growth effects in other jurisdictions." *Order No. 01-420 at 4*. If UM 995, with these divergent circumstances, is the source of Staff's "professional judgment" regarding the design of an appropriate PCA mechanism for PGE, it is no wonder that Staff's proposal fails so thoroughly to accommodate PGE's circumstances. *PGE/1800, Lesh/41*.

c. ICNU's Reference to Commission Precedent Is Selective, and Fails to Acknowledge the Circumstances Under Which a "Long-Term, Comprehensive PCA" Was in Place for PGE.

ICNU claims that Oregon utilities "traditionally have *not* had long-term, comprehensive PCAs." *ICNU Opening Brief at 13 (emphasis in original)*. In fact, however, PGE had a comprehensive PCA in place from 1979 until 1987 under which power cost variations due to hydro variability, fuel costs, thermal plant efficiency, and cost of purchased power were shared 80/20 between customers and PGE. *Docket UF 3518, Order No. 79-830*. ICNU attempts to distinguish this particular "long-term, comprehensive PCA" on the grounds that the "expectation" was claimed to be short-term and the "mechanism ultimately departed from expectations." *ICNU Opening Brief at 14*. This is a distinction without a difference; the facts speak for themselves as to whether "long-term, comprehensive PCAs" previously were favored by the Commission.

Moreover, ICNU does not address the underlying reason cited by the Commission when it terminated PGE's PCA mechanism in Dockets UE 47 and UE 48: that "[t]he original need for the power-cost adjustment, volatility of power costs, no longer exists for the same degree as existed in 1979" and "PGE can absorb the anticipated increases in power costs." *Order No. 87-1017 at 33.* As demonstrated by PGE throughout this proceeding, what may not have existed in 1987 does exist today, and warrants re-instituting a "long-term, comprehensive PCA." Volatility of power costs exists to a greater degree than was present in 1979; NVPC forecasts can vary greatly from year to year, as indicated by Figure 1 at PGE/300, Lesh/4, which shows PGE's forecasted annual NVPC for the 1993-2005 period. The cumulative increase from 1998 to 2002 was almost $600 million, and the decrease from 2002 to 2003 was more than $350 million. *PGE/1800, Lesh/4*. PGE has also demonstrated that it is unable to absorb the anticipated increases in power costs. With only 29% of its rate base comprising generation assets, PGE simply does not have an earnings cushion that would enable it to absorb the swings in NVPC that exist in today's energy environment. *PGE/2400, Lesh/18.*

With respect to more recent Commission precedent, ICNU claims that the proposed PCA is inconsistent with criteria enunciated by the Commission in Docket UE 165. *ICNU Opening Brief at 17-22*. PGE thoroughly discusses this precedent at *PGE/1800, Lesh/46-60*, and will not repeat that discussion here.

B. The Commission Should Continue to Calculate Plant Outages for Ratemaking Purposes Following Its Long-Standing Practice of Using a Rolling Four-Year Average.

For the most part, ICNU's and Staff's Opening Briefs offer no additional points to support their proposal to abandon the Commission's longstanding practice of using a four-year average outage rate in favor of reliance on various NERC data sources. ICNU continues to cite the Boardman outage as an example of "unusual outages that are not reasonably expected to recur over a four-year period." *ICNU Opening Brief at 31*. Given "the extreme nature of the Boardman outage," says ICNU, "it should not be used to normalize outage rates." *Id. at 32*. The solution for this particular outage, however, is to adopt Staff's proposal to remove the unusual event from the four-year rolling average *(Staff/100, Galbriath/7)*, not to abandon the methodology in its entirety.

ICNU's claim that continued use of a four-year rolling average would "provide a disincentive for utilities to maintain or improve plant efficiency" *(ICNU Opening Brief at 32)* is mere conjecture, and is unsupported by any evidence. *PGE/1900, Tinker-Schue-Drennan/41*. This claim also ignores the impact on a utility's net income in the year the forced outage occurs, as the utility replaces the power at prevailing market prices. *Id. at 41-42*. While inclusion of outages in test year assumptions for four years after occurrence may provide an opportunity to recover *some* losses, full cost recovery is far from certain. *Id. at 42*. Thus, the utility retains an adequate incentive "to maintain or improve plant efficiency."

ICNU also makes the disingenuous suggestion that using the NERC data would "allow the Company to reap the rewards of good performance" and would avoid "the need to examine the prudence and efficiency of PGE's resource management." *ICNU Opening Brief at 33*. Staff, on the other hand, does not include plants other than Boardman and Colstrip in its proposal because "PGE's other generating units did not experience any extraordinarily-long outages between 2002 and 2005." *Staff Amended Opening Brief at 4*. In other words, there are no "rewards of good performance" that would be reaped by PGE: If plant performance is good, the four-year rolling average will be used; if plant performance is bad (*i.e*., the occasional "extraordinarily-long outage"), the NERC data will be used. This is precisely the sort of "switching of methodologies" to game the ratemaking process against the utility that raises constitutional questions. *Duquesne v. Barasch, 488 U.S. 299, 315 (1989)* ("[A] state's decision to arbitrarily switch back and forth between methodologies in a way which required investors to bear the risk of bad investments at some times while denying them the benefit of good investments at others would raise serious constitutional questions."). There should be no switching back and forth between methodologies; the Commission should continue to use its traditional four-year rolling average, adjusted for the Boardman outage in the manner proposed by Staff.

C. Staff Cannot Shift the Burden to PGE to Substantiate Staff's Speculative Adjustment for "Extrinsic Value."

Given Staff's inability to quantify its speculative "extrinsic value" adjustment with any precision, Staff takes the remarkable position that it is PGE's burden to do so. According to Staff, "it is incumbent on PGE to provide persuasive evidence demonstrating what an adjustment with all impacts would be." *Staff Amended Opening Brief at 8*. Staff has not convinced the Commission that utilities should be required to use stochastic modeling for power costs. In this case, Staff again fails to make a persuasive case for stochastic modeling of power costs. Yet Staff is offering a speculative adjustment based on what it thinks the outcome of stochastic modeling would be, and is then claiming it is PGE's burden to quantify and substantiate Staff's speculative theory. This stands the burden of proof in ratemaking proceedings on its head. While PGE has the burden of proof under ORS 757.210 to submit evidence that its proposed rates are just and reasonable, PGE does not bear the burden of investigating and refining scattered theories advanced by other parties seeking to disprove the reasonableness of PGE's proposed rates. As stated by the Commission in Docket UG 132:

> Once the company has presented its evidence, the burden of going forward then shifts to the party or parties who oppose including the costs in the utility's revenue requirement. Staff or an intervenor, if it opposes the utility's claimed costs, may in turn show that the costs are not reasonable. *NW Natural, Order No. 99-697 at 3*.

PGE has presented its forecast of NVPC in accordance with established Commission precedent, *i.e*., without stochastic power cost modeling. If Staff wants to propose a different approach, it is Staff's burden, not PGE's, to determine the effects of inclusion of "all" variables.

PGE has responded to Staff's and ICNU's arguments regarding "extrinsic" value by retaining the services of PA Consulting to attempt to address the feasibility of stochastic modeling. The PA Report, submitted as PGE Exhibit 1803, addresses the impact of uncertainty on PGE's power costs and found that a base forecast of NVPC (using older data than that used to forecast 2007 NCPV) is approximately $10 million *less* than expected NVPC. In other words, the baseline NVPC forecast may well be too low, and a more complete assessment that captured the uncertainty of power cost forecast could *increase* the forecast. Yet Staff and ICNU propose that until stochastic modeling is used, the baseline forecast should be *decreased* from its already too low level. The proposed reductions to NVPC based on claimed "extrinsic" value should be rejected as unsupported by the evidence in the record.

D. The Commission Should Soundly Reject ICNU's Position that Utilities Do Not Need to Acquire Resources to Meet Peak Loads.

ICNU proposes to exclude the costs associated with the Super-Peak and Cold-Snap contracts because they "do not dispatch" to the average loads used to forecast NVPC with Monet. *ICNU Opening Brief at 28-30*. Of course these contracts don't dispatch. These contracts are the least cost way of assuring supply for peak loads and emergency events which are excluded from "normalized" test year ratemaking but thoroughly considered in resource planning. The Commission acknowledged PGE's 2002 IRP Action Plan in which PGE identified its capacity need, and approved the Request for Proposals ("RFP") which led to the acquisition of these contracts. The Commission cannot disallow the contracts without calling into question Oregon's commitment to resource adequacy and the viability of the IRP and RFP processes.

ICNU's claim with respect to these contracts stands in sharp contrast with CUB's position regarding PGE's claimed obligation to implement all aspects of an IRP Action Plan without deviation. In commenting on the prudence of Port Westward, CUB expresses the view that in order "to give integrity and meaning to the IRP process," it is necessary "to give some meaning to the acknowledgment of the best combination of resources." *CUB Opening Brief at 24*. The concern raised by CUB relates to the relationship between a prudence determination as to Port Westward in the context of PGE's implementation of the significant renewable energy component of its Action Plan, which suggests strict adherence to the best combination of options outlined in the Action Plan. *Id. at 21*. Yet PGE strictly adhered to the element of its 2002 IRP Action Plan requiring acquisition of 400 MW of tolling capability, and the response of ICNU is to urge rejection of the associated costs. The position taken by ICNU with respect to the capacity tolling contracts would make Commission acknowledgement of an IRP and the Action Plan meaningless. ICNU's proposed exclusion of the costs associated with the capacity tolling contracts should be rejected.

E. Port Westward

1. No Parties Dispute that the Record Contains a Prima Facie Case for the Inclusion of Port Westward as Prudent.

CUB's opening brief addresses at length its novel theory that the prudence of a single plant, Port Westward, cannot be established when PGE's 2002 IRP Action Plan contained a mix of resources. *CUB Opening Brief at 20.* CUB's theory is that the entire Action Plan must be addressed. CUB does conclude, however, that the evidence in this docket regarding Port Westward "is sufficient to create a prima facie case of prudence, given the activity on the renewable energy acquisitions." *Id. at 22*. That conclusion is sufficient for the resolution of this case, and because of that the Commission may determine that it does not need to address CUB's argument. However, if the Commission does address the argument, PGE provides the following brief comments.

CUB argues that while Port Westward may be prudent and properly included in rates at this time, if PGE does not acquire the renewable resources identified in the Action Plan then it would be appropriate to revisit the rate treatment of Port Westward. *Id. at 23*. This violates a fundamental tenet of regulation – the prudence of a decision is determined based upon the information known at the time the decision was made. A decision that was prudent when made cannot become imprudent because of subsequent events.

CUB's brief quotes Staff's approach to this issue as set forth in Staff's response to PGE data request 85, submitted as PGE/2501, Lobdell/1. CUB then correctly criticizes Staff's idea that a Commission could, after the fact, make an imputation in rates for a decision to not acquire a resource that was contained in an IRP Action Plan. PGE agrees that such an approach would be improper. Yet CUB goes on to argue for what is effectively the same thing – revisiting, possibly years later, the rate treatment of a plant that was built by comparison to the costs and benefits if the Action Plan had been fully implemented. That approach suffers from the same infirmity as Staff's approach that CUB criticizes – a retroactive look at the ratemaking treatment of a plant based on other resources that were not acquired. That is just as improper as Staff's idea.

CUB's stated concern is that renewable resources identified in the action plan may not be built. PGE's testimony makes clear that CUB's concern is misplaced in this case. PGE is on schedule to have slightly more renewable resources in operation by the end of 2007 than identified in the Action Plan. It is not necessary to even address CUB's novel theories regarding the ratemaking treatment of new generating resources, but if the Commission does address them they should be rejected.

2. PGE's Proposal Addresses CUB's Concerns Regarding the Timing of Port Westward's Inclusion in Rates.

In its opening brief, CUB continues to complain about a non-existing problem with the Commission dealing with Port Westward costs in this consolidated docket. CUB correctly points out that until an investment is used and useful, it should not be included in rates. That is precisely what PGE has requested in this case. In fact, Docket UE 184, a general rate case docket consolidated herein, deals specifically with the inclusion of Port Westward in rates when it goes into service. CUB's arguments are misplaced.

In connection with its concerns about the timing of the inclusion of Port Westward costs in rates, CUB has offered three proposed conditions. As explained in PGE's testimony, PGE acknowledges the concern behind CUB's proposed conditions, but the conditions are unnecessarily restrictive. CUB's proposal is based on the premise that the projected test-year cost data used in this docket would become overly stale and not properly useful in 30 days. That is not the case. PGE proposed revisions to CUB's conditions to provide more reasonable time limits, but CUB took PGE's attempt to work with CUB as confirmation of their concerns and made no attempt to move from their original proposal. *CUB Opening Brief at 27*. PGE proposes that the Commission set the following conditions for inclusion of Port Westward costs and benefits in rates:

1. Tariffs from this proceeding are valid if Port Westward is in service within three months of March 1, 2007.
2. If Port Westward is not in service within three months of March 1, 2007, then PGE must reopen this docket.
3. If Port Westward is not in service by year end 2007, PGE must file a new rate case.

These are reasonable deadlines that address the concerns raised.

3. Port Westward Is Properly Reflected in Power Costs.

a. The Dispatch Benefits of Port Westward Are Not Understated.

ICNU claims that PGE has understated the dispatch benefits of Port Westward. *ICNU Opening Brief at 30-31*. PGE has not. PGE computed the Port Westward rates that would be in effect only during the 10-month period, March-December, when Port Westward is expected to be in service. This properly matches the costs and benefits of Port Westward to when it is in service. This will also ensure that PGE's projected revenues in 2007 match PGE's projected NVPC in 2007. ICNU's analysis relies on assumptions regarding January and February dispatch benefits, but January and February are irrelevant to the calculation. PGE does recognize, however, that if the Annual Update Tariff or some other means to incorporate a new NVPC forecast into rates as of January 2008, is not adopted then the power cost model will need to consider Port Westward dispatch in all months. *PGE/1900, Tinker-Schue-Drennan/51*.

b. There Is No Basis for Including the Dispatch Benefits of Port Westward Prior to Operation.

In direct contradiction to its arguments addressed above that the costs of Port Westward should not impact rates until the plant is in service, CUB argues that the dispatch benefits of Port Westward should be included before Port Westward begins service. *CUB Opening Brief at 29-30*. PGE developed its NVPC forecast to include the costs and benefits of Port Westward during the time it is expected to be in service. This is consistent with the used and useful standard. CUB argues that PGE's UE 180 test year NVPC forecast has a "phantom open position" resulting from the expected dispatch of Port Westward starting in March. CUB's solution is to effectively establish rates based on a two-month test period first, then a ten month test period later. CUB claims that this needs to be done because PGE's method increases NVPC. It does not. PGE explained in its testimony that NVPC over the 12 months of 2007 is exactly the same. *PGE/1900, Tinker-Schue-Drennan/47-51*. The NVPC benefit of Port Westward is exactly the same as the "phantom open position."

A power cost model as advocated by CUB could be produced. It would have slightly lower costs in January and February, and slightly higher costs for the remainder of the year. Total cost over the year would be the same. CUB's approach would also be more complicated and is unnecessary. PGE's approach meets the principles articulated in its testimony: the dispatch benefits follow the cost recovery of Port Westward, and projected revenues equal expected NVPC. CUB's arguments should be rejected.

F. Staff's Proposal That the Commission Reduce NVPC to Reflect Ancillary Services Revenue Should be Rejected.

In discussing Staff's proposed ancillary services adjustment, Staff's opening brief claims that "in the absence of persuasive evidence showing that staff's adjustment is overstated, the Commission should reject PGE's assertion that it is." PGE has, in fact, demonstrated that Staff's adjustment is overstated. Staff's proposed adjustment "does not remove approximately $100,000 in grid management charges imposed by the California Independent System Operator." *PGE/2600, Tinker-Schue-Drennan/16*. PGE's rebuttal testimony also stated that sales from ancillary services effectively shifts hydro production from peak to off-peak hours. *PGE/1900, Tinker-Schue-Drennan/46-47*. The cost of that shift is not modeled in Monet power costs used in this docket, again making Staff's proposed adjustment overstated. PGE's testimony also demonstrates that there is considerable uncertainty in the revenue projection for ancillary services. *Id.*

Staff's proposed credit for ancillary service revenue has not been adequately supported. It is based on limited data causing the projection to be uncertain, and does not include the costs associated with the sale of ancillary services. The proposed reduction should be rejected.

IV. OTHER ISSUES

A. The Commission Should Approve the Inclusion of Income Taxes in PGE's Rates.

1. It Was Prudent for PGE to Maintain Its Corporate Form During the Enron Bankruptcy.

Consistent with long-standing practice, PGE's proposed rates reflect PGE's expected income tax expenses. The tax portion of PGE's rates will ultimately be trued up to reflect PGE's actual tax expenses, pursuant to SB 408. However, the City of Portland ("City") argues that the Commission should allow for no income taxes whatsoever in PGE's rates because, according to the City, it is theoretically possible that PGE might have avoided paying taxes altogether through the corporate restructuring scheme described in Mr. Jubb's testimony. *COP/100, Jubb/10*. When a party challenges a particular cost incurred by a utility as imprudent, the Commission's job is to examine the objective reasonableness of the utility's actions at the time it acted. *In the Matter of PacifiCorp, UE 134/UM 1047, Order No. 02-820 at 5 (2002)*. "If the action was reasonable, then the expense was prudently incurred." *Id.* If the action was not reasonable, then the expense was not prudently incurred and the Commission will not include the expense in rates. *See id.* In making its determination, the Commission is not charged with weighing all the options and exercising independent business judgment. *See In the Matter of Tariffs Filed by Juniper Utility Company, UW 65/UW 68, Order No. 00-543 (2000)* ("We were not granted the statutory authority in a rate case to make business decisions for a utility regarding the advantages and disadvantages of a particular business proposal or plan."). Rather, the Commission should exclude a cost from rates only if the utility acted unreasonably. *See PacifiCorp, Order No. 02-820 at 5* ("If the action was reasonable, then the expense was prudently incurred.").

PGE did not act unreasonably or imprudently by maintaining its existing corporate status rather than undertaking a risky scheme that (1) would have offered uncertain tax benefits, (2) would have exposed PGE to unnecessary legal risks, and (3) likely would not have been approved by all the necessary parties even if it were economically and legally feasible. To the contrary, it would have been imprudent for PGE to incur the substantial costs inherent in pursuing the City's suggestion, and the City would in all likelihood now be seeking to have those costs excluded from PGE's rates if PGE had in fact pursued it.

There is substantial testimony in the record regarding the flaws in the City's hypothetical tax strategy. *PGE/1700, Piro-Tamlyn/1-18.* In short, the City describes a circular transaction in which PGE would have converted from a corporation to an LLC at some time prior to the distribution of PGE stock to Enron creditors, distributed PGE LLC membership interests to creditors instead of publicly-listed PGE stock, and then converted back to a corporation. The City contends that PGE thereby could have used the tax benefits of all of Enron's losses for free and potentially avoided paying taxes for the next 20 years. *COP/100, Jubb/9-10.*

However, the City ignores the realities of the scheme it proposes. As explained in PGE's testimony, the hypothetical scheme would generate little, if any, net savings for customers, and could result in the imposition of fines and interest that would actually increase PGE's expenses. Finally, the City's tax scheme is not feasible at all unless PGE's preferred shareholders agreed to sell their shares, and a variety of state and federal regulatory bodies approved the transaction, prerequisites for which there is no evidence.

Moreover, there are several erroneous assumptions in Mr. Jubb's savings calculations. First, Mr. Jubb bases his $1.7 billion step-up on the value of PGE's stock on the first day it traded on the New York Stock Exchange ("NYSE"). However, the City's scheme would have required distribution of LLC membership interests instead of stock, which LLC interests would have been significantly less valuable than publicly-listed stock.[7] *PGE/1700, Piro-Tamlyn/9*. Second, Mr. Jubb's stated "tax basis book value" is plainly incorrect. *Id.* Third, Mr. Jubb does not account for the fact that converting to an LLC could eliminate PGE's accumulated deferred taxes, thereby eliminating about $200 million in rate base offsets and increasing rates by about $25 million per year. *Id. at 9-10*. Fourth, Mr. Jubb assigns 100% of PGE's value to depreciable assets, which is a gross oversimplification. *Id. at 11*. Fifth, Mr. Jubb does not recognize any of the administrative and legal costs PGE would have had to incur to pursue, let alone implement, the City's scheme. *Id.* Sixth, Mr. Jubb assumes all of Enron's net operating losses would have been available to PGE for free, ignoring that it is unknown whether Enron may, in fact, utilize some or all of those losses or may demand compensation for their use. At a minimum, it is in no way certain that Enron would have been willing to foreclose the option of preserving its losses for other uses. *Id. at 13*.

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[7] Although the City incorrectly suggests otherwise, PGE was also required to register its common shares with the SEC, whether or not it listed them on the NYSE. *See 15 USC §§ 78l(b) and (g)*.

In light of all the foregoing, it is not at all clear that the City's hypothetical transaction would have resulted in any tax savings to PGE or its customers. Moreover, even if it did have the potential to provide some financial benefit, PGE would have had to consider the substantial hurdles to actually completing the transaction, and the attendant costs. The transaction would have required, at a minimum, legal review of all of PGE's existing contracts and debt instruments to ensure they permitted the change in corporate structure, agreement by preferred shareholders to redeem all PGE shares, the approval of Enron, the approval of Enron's Creditor's Committee, the approval of the federal bankruptcy court overseeing the Enron bankruptcy, and likely the approval of several federal and state agencies. *PGE/1700, Piro-Tamlyn/7, 13*. It is particularly unlikely that Enron's Creditor's Committee would have approved the transaction since it would have resulted in creditors receiving LLC membership shares with significantly less value than publicly-listed PGE stock. *PGE/1700, Piro-Tamlyn/7*. The same is true of the Enron Board. *Id. at 13*.

Given the context of the Enron bankruptcy, it is highly questionable whether all the necessary review and approvals could have been completed in a timely fashion. That is especially so since Enron tried to sell PGE for some time before ultimately deciding to distribute its stock to creditors, during which time it would have been imprudent for PGE to incur significant expenses pursuing such a strategy. *PGE/1700, Piro-Tamlyn/14-15*.

Ultimately, even if the transaction had substantive merit and could be completed in a timely manner, it would have been imprudent for PGE to expose itself and its customers to the risk of fines and penalties for violating the Internal Revenue Service's prohibition against step-transactions, as well as the substance-over-form doctrine.

The City's statement that this type of scheme has been "specifically considered and approved by the Internal Revenue Service in its administrative determinations, and in court opinions" is just wrong. *COP Opening Brief at 3*. The decisions the City identifies either concern a single uncontroversial part of the City's multi-step scheme[8] or simply have no relevance to what the City proposes.[9] In not a single case, did the courts or the IRS approve a transaction like the City's scheme.[10]

Given all the costs and risks associated with the hypothetical transaction, it was reasonable for PGE to maintain its corporate status rather than attempt a circular scheme designed solely to eliminate its income tax obligations. Mr. Tamlyn, PGE's Tax Director, testified that he considered the risks of the suggested transaction unacceptable and imprudent, especially given the upheaval related to the Enron bankruptcy, and that he absolutely would not have recommended that PGE undertake the transaction if he had been Tax Director during the relevant time period. *PGE/1700, Piro-Tamlyn/15*. Mr. Piro, PGE's CFO at present and during the relevant time period, also testified that he would not have considered the transaction a prudent course of action, would not have recommended that PGE expend potentially millions of dollars pursuing such a scheme, and would not have recommended the transaction to PGE's Board of Directors. *PGE/1700, Piro-Tamlyn/15*. The City chose not to reply to this testimony.

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[8] *Granite Trust Co. v. United States*, *238 F2d 670 (1st Cir 1956)* (affirming that a §322 liquidation of a corporation is allowed by statute); *IRS Priv Ltr Rul 9822037 (May 29, 1998)* (recognizing that §322 authorizes the liquidation of a corporation); *Littriello v. United States, 95 AFTR2d 2005-2581 (WD Ky 2005)* (affirming IRS check-the-box regulations).

[9] *IRS Rev Rul 2004-77, 2004-2 CB 119 (2004)* (holding that if an entity has two members one of which is a disregarded entity separate from the other member, the entity is either a "disregarded" entity or an association taxable as a corporation); *Dover Corp. v. Commissioner, 122 TC 324, 351 (2004)* (involving liquidation of a foreign subsidiary in order to avoid having gain characterized as foreign personal holding company income).

[10] Other cases the City cites are either irrelevant, involving utilities that imprudently elected to adopt unique, risky tax positions (*see, e.g., City and County of San Francisco v. Public Utilities Com., 6 Cal3d 119, 490 P2d 798 (1971)* (affirming disallowance of tax expense because unlike "all other utilities" the utility in that case elected not to use available accelerated tax deductions), or support PGE's position that its forecasted actual tax expense, not a hypothetical, speculative tax expense, should be used in setting its rates (*see, e.g.*, *Public Utility Com. v. Houston Lighting & Power Co., 748 SW2d 439, 442 (Tx 1987)* (holding that utility could not recover tax expense it did not in fact incur)).

The City's hypothetical tax strategy is nowhere near certain enough to justify the Commission even considering excluding PGE's actual income tax liabilities from its rates. The Commission rejected an analogous argument in *Juniper Utility Company*. In that case, the City of Bend offered to connect Juniper Utility Company to the City of Bend's sewer system, but the utility declined due to concerns about the financial impact of the transaction, its desire to retain access to sewer by-products, and because it wished to remain independent. *See Juniper Utility Company, Order No. 00-543 at 7-8*. Commission Staff took the position that it was imprudent and unreasonable for the utility not to connect to the city sewer system, and that any costs the utility incurred that it would not have incurred if it had connected should therefore be disallowed from rates. *Id. at 9*. The Commission disagreed, stating:

> In the present case, we are being asked to disallow JUC's current expense of its wastewater connection because it is greater than a hypothetical future expense of a wastewater connection to the City. * * * If the evidence had shown that JUC had an established lower cost option of connecting to the City, and that the expenses were imprudent, the Commission could have disallowed any expenses incurred by JUC's decision to remain independent. The rates then would have been based only on the allowed expenses. In this case, however, the record is incomplete in establishing what the cost would be to JUC if it connected to the City. Therefore, the rates in this case will be set without regard to the possible connection to the City.

Id.

In this case, not only is it unclear what PGE's tax expense would have been under the City's scheme, but the feasibility of the proposed transaction is speculative at best.

In a final effort to avoid the uncertainties of its hypothetical tax strategy, the City states that the proposed scheme is merely an "example" and that, "[i]n the end, the City is not advocating that PGE should have been required to follow a specific process of corporate reorganization. Rather, the City is noting that various legal means exist by which utility management could have engaged in reasonable tax planning that would have benefited ratepayers." *City's Opening Brief at 4.* In fact, the City makes no other proposals, and the one proposal it otherwise appears to advocate is far too uncertain to establish that PGE acted unreasonably and imprudently by choosing to maintain its existing corporate status. PGE's inclusion of income tax expenses in its proposed rates is fair, just and reasonable.

2. There Is No Basis to Order a Refund of Past Taxes.

Historically, the Commission has set PGE's rates based on its stand-alone tax liability, including throughout the entire time Enron owned PGE. Going forward, the state legislature has specifically addressed how utilities' tax expense will be recovered from customers. Nonetheless, the City continues to argue that it was not good policy for the Commission to utilize the stand-alone approach in past ratemaking and that the Commission, therefore, should order PGE to refund amounts collected for taxes during the time PGE was part of Enron's consolidated tax group.

There is no lawful basis to order a refund. The City made the same argument in UM 1262, and the Commission properly rejected it. *See City of Portland v. Portland General Electric Co., UM 1262, PUC Order No. 06-636 (Nov. 17, 2006).* No purpose will be served by rehashing the issue here, as it was thoroughly briefed and resolved in that proceeding.

3. The Commission Will Receive Annual Tax Reports from PGE.

Pursuant to the requirements of SB 408, PGE, like all utilities subject to the statute, will submit annual tax reports to the Commission. The Commission will review such reports and conduct the proceedings required by statute and Commission rule. *See ORS 757.268(4); OAR 860-022-0041(7).* There is no reason or basis for the Commission to implement additional reporting requirements for PGE, or for the Commission to "commit to actively monitor PGE's effective tax rates" *(City Opening Brief at 17)* more than any other utility's effective tax rates.

PGE disagrees with the City that SB 408 gives it an incentive to avoid tax savings. *PGE/1700, Piro-Tamlyn/3-5*. To the extent the City believes that is the case, however, the issue applies equally to all utilities, and the City should have addressed its concern to the legislature before the bill was passed and/or to the Commission in connection with the adoption of permanent rules implementing SB 408. It is not readily apparent how utilities filing an additional report or the Commission "actively monitoring" effective tax rates would reinstate the incentive that the City asserts SB 408 eliminated. *PGE/1700, Piro-Tamlyn/5-6*. However, that is a matter of policymaking, not ratemaking. For purposes of ratemaking, SB 408 and its implementing rules apply equally to PGE as all other utilities, and generalized suspicion toward PGE due to its prior ownership does not justify adopting special additional rules only for PGE.

4. The Legislature and the Commission Have Already Addressed PGE's Deferred Taxes in SB 408 and Its Implementing Rules.

Finally, the City argues that the Commission should order PGE to refund approximately $280 million in deferred income taxes. The City claims that, otherwise, customers will be "double charged." *City Opening Brief at 17-18*. That is not true. Customers receive a deduction from rate base for PGE's deferred tax balance, which currently reduces PGE's rates by approximately $25 million per year. *PGE/1700, Piro-Tamlyn/9, 16*. The City's proposed refund would violate IRS normalization rules and jeopardize PGE's ability to use accelerated depreciation available under the federal tax code. *Id.* Moreover, the legislature has specifically addressed deferred taxes in SB 408, allowing the Commission to "authorize a public utility to include in rates: (a) Deferred taxes resulting from accelerated depreciation or other tax treatment of utility investment; and (b) Tax requirements and benefits that are required to be included in order to ensure compliance with the normalization requirements of federal tax law." *ORS 757.268(8)*. The Commission has also addressed deferred taxes in its permanent rules implementing SB 408, to which rulemaking proceeding the City was a party. *See OAR 860-022-0041(2)(b) and (8)(f).*

Pursuant to both cost-of-service ratemaking principles and SB 408, PGE's customers pay only once for income taxes, in the year the taxes are reported in PGE's results of operations report. *PGE/1700, Piro-Tamlyn/16*. There is no reason or basis for the Commission to adopt a special approach to deferred taxes applicable only to PGE, let alone do so in order to solve a problem that does not exist. There is nothing improper about PGE retaining a deferred tax balance.

B. PGE Does Not Oppose Eugene Water & Electric Board's Request Regarding PGE's Contributions to the Nuclear Decommissioning Fund.

As part of this case, PGE proposes that its contribution to the Nuclear Decommissioning Trust ("NDT") be reduced from $14.04 million per year through 2011 to $4.65 million per year extended through 2024. *PGE/1000, Quennoz-Nichols/1*. PGE also proposes to return $20 million to customers from the NDT. These proposals are possible because PGE has consistently completed decommissioning projects under budget. The $20 million to be returned to customers is the accrued savings from the UE 115 revised decommissioning costs. *Id*. The proposal to extend the payments to 2024 will also better match contributions to the NDT with costs. No party has opposed these proposals.

The Eugene Water & Electric Board ("EWEB") filed testimony and an opening brief requesting that, regardless of whether the Commission approves PGE's proposals, the Commission "should expressly state that PGE is authorized to continue collecting funds from ratepayers to complete the task of decommissioning Trojan, even if such funds must be collected beyond 2011." *EWEB Opening Brief at 1.* EWEB's request is consistent with PGE's NDT cost recovery proposal, and PGE does not oppose the request.

V. CONCLUSION

For the reasons set forth above, Portland General Electric Company requests that the Commission approve PGE's revised tariff schedules and approve its requested revenue requirement increase in this case.

DATED: December 1, 2006

Respectfully submitted,

/S/ DOUGLAS C. TINGEY

DOUGLAS C. TINGEY, OSB No. 04436
Portland General Electric Company
121 SW Salmon Street, 1WTC1300
Portland, OR 97204
Telephone: (503) 464-8926
Facsimile: (503) 464-2200
E-Mail: doug.tingey@pgn.com

/S/ DOUGLAS C. TINGEY FOR JAMES M. VAN NOSTRAND

JAMES M. VAN NOSTRAND, OSB No. 79428
Perkins Coie LLP
1120 NW Couch Street, 10th Floor
Portland, OR 97209-4128
Telephone: (503) 727-2162
Facsimile: (503) 346-2162
E-Mail: JVanNostrand@perkinscoie.com

Portland General Electric Company
Legal Department
121 SW Salmon Street • Portland, Oregon 97204
(503) 464-8926 • facsimile (503) 464-2200

Douglas C. Tingey
Assistant General Counsel

December 1, 2006

Via Electronic Filing and U.S. Mail

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Attention: Filing Center
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Re: UE 180, UE 181 AND UE 184

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Enclosed for filing in the captioned dockets are:

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This document is being filed by electronic mail with the Filing Center.

An extra copy of this cover letter is enclosed. Please date stamp the extra copy and return it to me in the envelope provided.

Thank you in advance for your assistance.

Sincerely,

DOUGLAS C. TINGEY

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CERTIFICATE OF SERVICE

I hereby certify that I have this day caused the **PORTLAND GENERAL ELECTRIC COMPANY'S REPLY BRIEF** to be served by electronic mail to those parties whose email addresses appear on the attached service list, and by First Class US Mail, postage prepaid and properly addressed, to those parties on the attached service list who have not waived paper service.

Dated at Portland, Oregon, this 1st day of December 2006.

DOUGLAS C. TINGEY

SERVICE LIST

UE 180, UE 181, UE 184

KURT J BOEHM, ATTORNEY
BOEHM KURTZ & LOWRY
36 E 7th ST - STE 1510
CINCINNATI OH 45202
kboehm@bkllawfirm.com

MICHAEL L KURTZ
BOEHM KURTZ & LOWRY
36 E 7TH ST STE 1510
CINCINNATI OH 45202-4454
mkurtz@bkllawfirm.com

GEOFFREY M KRONICK
BONNEVILLE POWER
ADMINISTRATION
PO BOX 3621 LC7
PORTLAND OR 97208-3621
gmkronick@bpa.gov

CRAIG SMITH
BONNEVILLE POWER
ADMINISTRATION
PO BOX 3621--L7
PORTLAND OR 97208-3621
cmsmith@bpa.gov

JAMES T SELECKY
BRUBAKER & ASSOCIATES, INC.
1215 FERN RIDGE PKWY, SUITE 208
ST. LOUIS MO 63141
jtselecky@consultbai.com

TAMARA FAUCETTE
CABLE HUSTON BENEDICT
HAAGENSEN & LLOYD LLP
1001 SW 5TH AVE STE 2000
PORTLAND OR 97204
tfaucette@chbh.com

CHAD M STOKES
CABLE HUSTON BENEDICT
HAAGENSEN & LLOYD, LLP
1001 SW 5TH - STE 2000
PORTLAND OR 97204
cstokes@chbh.com

LOWREY R BROWN
CITIZENS' UTILITY BOARD OF
OREGON
610 SW BROADWAY - STE 308
PORTLAND OR 97205
lowrey@oregoncub.org

JASON EISDORFER
CITIZENS' UTILITY BOARD OF
OREGON
610 SW BROADWAY STE 308
PORTLAND OR 97205
dockets@oregoncub.org

JIM ABRAHAMSON, COORDINATOR
COMMUNITY ACTION DIRECTORS
OF OREGON
PO BOX 7964
SALEM OR 97303-0208
jim@cado-oregon.org

S BRADLEY VAN CLEVE
DAVISON VAN CLEVE PC
333 SW TAYLOR - STE 400
PORTLAND OR 97204
mail@dvclaw.com

STEPHANIE S ANDRUS
ASSISTANT ATTORNEY GENERAL
DEPARTMENT OF JUSTICE
REGULATED UTILITY & BUSINESS SECTION
1162 COURT ST NE
SALEM OR 97301-4096
stephanie.andrus@state.or.us

LAURA BEANE MANAGER
PACIFICORP
825 MULTNOMAH STE 2000
PORTLAND OR 97232-2153
laura.beane@pacificorp.com

ANN L. FISHER
AF LEGAL & CONSULTING SERVICES
PO Box 25302
PORTLAND, OR 97298-0302
energlaw@aol.com

LORNE WHITTLES
EPCOR MERCHANT CAPITAL
1161 W. RIVER STREET, SUITE 250
BOISE, IDAHO 83702
lwhittles@epcor.ca

ELISA M. LARSON
ASSOCIATE COUNSEL
NORTHWEST NATURAL
220 NW 2ND AVENUE
PORTLAND, OREGON 97209
elisa.larson@nwnatural.com

ALEX MILLER
NORTHWEST NATURAL
220 NW SECOND AVENUE
PORTLAND, OREGON 97209-3991
alex.miller@nwnatural.com

BENJAMIN WALTERS
(waived paper service)
bwalters@ci.portland.or.us

RICHARD GRAY
(waived paper service)
richard.gray@pdxtrans.org

DAVID TOOZE
(waived paper service)
dtooze@ci.portland.or.us

SCOTT H. DEBROFF
RIVER CHASE OFFICE CENTER
4431 NORTH FRONT STREET
HARRISBURG, PA 17110
sdebroff@sasllp.com

WILLIAM H. CHEN
CONSTELLATION NEWENERGY INC.
2175 N. CALIFORNIA BLVD.
SUITE 300
WALNUT CREEK, CA 94596
bill.chen@constellation.com

DANIEL W. MEEK
DANIEL W. MEEK ATTORNEY AT LAW
10949 SW 4th AVENUE
PORTLAND, OR 97219
dan@meek.net

THEODORE E ROBERTS
SEMPRA GLOBAL
101 ASH ST HQ 13D
SAN DIEGO CA 92101-3017
troberts@sempra.com

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

KATHERINE A MCDOWELL
MCDOWELL & ASSOCIATES
520 SW 6TH AVENUE
SUITE 830
PORTLAND, OREGON 97204
katherine@mcd-law.com

JIM DEASON
1 SW COLUMBIA STREET
SUITE 1600
PORTLAND, OREGON 97258-2014
jimdeason@comcast.net

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

LINDA K. WILLIAMS
KAFOURY AND MCDOUGAL
10266 SW LANCASTER ROAD
PORTLAND, OR 97219-6305
Linda@lindawilliams.net

ANDREA FOGUE
SENIOR STAFF ASSOCIATE
LEAGUE OF OREGON CITIES
PO BOX 928
1201 COURT STREET NE, SUITE 200
SALEM, OR 97308
afogue@orcities.org

LON L. PETERS
(waived paper service)
lpeters@pacifier.com

HARVARD P. SPIGAL
PRESTON GATES AND ELLIS
222 SW COLUMBIA STREET
SUITE 1400
PORTLAND, OREGON 97201-6632
hspigal@prestongates.com

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
TRANSPORTATION OPERATIONS
CITY OF GRESHAM
1333 NW EASTMAN PARKWAY
GRESHAM, OR 97030
john.harris@ci.gresham.or.us