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),	)))))))))
In the Matter of PORTLAND GENERAL ELECTRIC COMPANY Request for a General Rate Revision relating to the Port Westward plant (UE 184).	))))))))))

REPLY BRIEF OF

THE INDUSTRIAL CUSTOMERS OF NORTHWEST UTILITIES

December 1, 2006

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I. INTRODUCTION

Portland General Electric Company's ("PGE" or the "Company") opening brief provides no new arguments to justify the Company's proposals in this Docket. PGE rehashes its testimony without seriously addressing the flaws in the Company's proposed power cost framework, net variable power cost ("NVPC") forecast, and cost of capital recommendations. The Industrial Customers of Northwest Utilities ("ICNU") explained in its opening brief that those flawed proposals inflate the requested rate increase and would result in unjust and unreasonable rates.

PGE urges the Commission to adopt the Company's power cost framework and cost of capital, based on the Company's claimed need to mitigate "cost-of-service risk" and Standard & Poor's ("S&P") alleged concern about Oregon's regulatory environment. ICNU's opening brief demonstrated that S&P's recent report regarding PGE is not an objective assessment, and the Commission should disregard it. See ICNU Opening Brief at 7-12. The Commission similarly lacks any basis to approve PGE's proposed power cost framework or cost of capital based on the notion of "cost-of-service risk." Cost-of-service risk is not a legitimate risk to consider in ratemaking; it is a concept that PGE created to justify its proposals.

PGE's cost of capital discussion attempts to deny the impact of Enron ownership and to justify the Company's equity-rich capital structure and inflated 10.75% return on equity ("ROE") proposal based on "PGE-specific" risk. The evidence demonstrates the fallacy in these arguments. Enron's bankruptcy had a direct effect on PGE's cost of debt and current common equity ratio, and the Company has agreed "not to seek recovery" of increases in PGE's cost of capital and revenue requirement that result from Enron ownership. Re PGE, OPUC Docket Nos.

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UF 4218 and UM 1206, Order No. 05-1250, Appendix A at 4 (Dec. 14, 2005). Furthermore, the record lacks any credible evidence of PGE-specific risk to justify authorizing an ROE that exceeds the mid-point of the range of results for a properly constructed proxy group of comparable utilities. ICNU and Citizens' Utility Board ("CUB") witness Michael Gorman constructed such a comparable group to formulate his recommended 9.9% ROE, and PGE does not dispute his methodology or calculations.

PGE's opening brief is, in many ways, a study in contradiction. PGE urges the Commission to revert back to the "policy" that supported the PGE PCA approved in 1979, but the Company argues the increased power cost volatility in recent years justifies adopting a whole new power cost framework. PGE Opening Brief at 33, 36. PGE suggests that the Commission conduct a policy investigation regarding the appropriate forced outage rate methodology, but the Company disregards the Commission's recent policy statements about power cost recovery and the elements of an appropriate PCA. Id. at 34-40, 44. PGE argues that the fate of the Company's proposals in this case is particularly important because investors expect "strong regulatory support" for the new, publicly-traded PGE, but the Company's evidence and arguments in support of those proposals lack credibility. Id. at 4. Insufficient evidence, inconsistency, and lack of credibility are the downfall of PGE's case. The Commission cannot lend strong regulatory support based on conflicting arguments and dubious evidence.

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II. CONTESTED ISSUES

A. Power Cost Framework

1. PGE Created the Concept of Cost-of-Service Risk to Justify Its Proposed Power Cost Framework

PGE claims that both the Company and its customers bear "cost-of-service risk." Id. at 31. PGE defines this risk as "the risk that PGE's Commission-set cost-of-service prices do not reflect PGE's actual cost of providing on demand electric service to customers." Id. According to PGE, the Company designed its proposed power cost framework to mitigate this risk. Id.

Cost-of-service risk is not a "risk" in any conventional sense of the word; it is a concept that PGE created based on the mistaken motion that the Company's prices must reflect all of the costs that PGE actually incurs in providing service. This flatly contradicts the Commission's repeated determination that there is a range of normal power cost variation that the utility must absorb between rate cases. Re PGE, OPUC Docket No. UM 1071, Order No. 04-108 at 8-9. (Mar. 2, 2004).

a. PGE's Request for a Power Cost Framework That Mitigates Cost-of-Service Risk Seeks Adoption of a New Ratemaking Construct

PGE's suggestion that the OPUC's goal should be to mitigate cost-of-service risk effectively seeks a new ratemaking paradigm in which the Commission sets power costs in a rate case using a forecast, and then PGE constantly trues-up that forecast to reflect historic costs, with interest, once the rate case is over. This "cost plus" form of ratemaking substantially departs from the Commission's definition of the ratemaking construct:

> All the Commission is obliged or authorized to do is prescribe or approve rates which, in the context of the application of rate case

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> principles in the case only, provide the utility with an opportunity to earn a reasonable return on property used and useful in presently providing service.
>
> As every utility scholar knows and declares: The rate case decision must provide the opportunity only, no promises, no guarantees. This means that once a rate case is completed and rates are set which, by the court standards, provide the opportunity, it makes no difference what actually happens from then on. The reasonableness of the rates under consideration is judged at an instant in time - namely, the rate case decision.

Re PGE, OPUC Docket Nos. UE 47 and UE 48, Order No. 89-687 at 8 (May 24, 1989) (internal citations omitted).

PGE does not seek rates set "at an instant in time" based on the evidence in the record. PGE requests a framework that provides the Company a cost of service "guarantee" that it will recovery all power costs forecast on annual basis and 90% of any costs that exceed that forecast during the year. This flatly contradicts the Commission's statement that there are no guarantees. Id.

PGE's suggested framework is especially inappropriate from a policy perspective, because the Company proposes two different mechanisms to update and true-up power costs. This framework shifts power cost variation risk to customers through a process that gives PGE the best of all ratemaking worlds: rates are set in a general rate case based on forecast power costs; rates are then reset annually based on the most recent forecast; and, finally, rates are then trued-up to PGE's actual costs incurred (with interest) within the year. Under PGE's proposed "cost plus" ratemaking regime, the Company will be relieved of most of the risk of operating its business.

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Adopting PGE's proposed framework likely will eliminate the general rate case as the Commission's primary ratemaking tool for the Company. PGE argues that power costs represent two-thirds of the Company's revenue requirement and that NVPC in particular represent approximately one-half of the requested revenue increase in this case. PGE Opening Brief at 30. If PGE can both update and true-up power costs every year, the Company will have little need to file a rate case to address costs that allegedly have less impact on overall revenues. See id. at 29 (stating that cost of capital constitutes only 11% of PGE's revenue requirement). This has the potential to eliminate scrutiny of PGE's earnings for an extended time while the Company performs multiple updates to power costs each year.

b. PGE's Proposal to Mitigate Cost-of-Service Risk Removes All Incentive to Manage Power Costs

PGE's proposed power cost framework also will eliminate the incentive for the Company to control its power costs. Indeed, PGE's proposed PCA includes no deadband, no gradation of sharing bands, and the Company will bear only 10% of all power cost variations in any one year before being able to update its power cost forecast for the next year. Furthermore, PGE retains the ability to seek a deferred account if the Company feels that absorbing even 10% of any power cost variations is too much. As noted in ICNU's testimony and opening brief, the reliability of many of PGE's thermal plants is below national averages for comparable plants. ICNU/103, Falkenberg/13-14; ICNU Opening Brief at 33. Adopting PGE's power cost framework will create little incentive to address this problem.

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c. PGE's Request for a Higher ROE to Address Cost-of-Service Risk Demonstrates the Fallacy Behind PGE's Concept

PGE argues that the Commission must adjust the Company's authorized ROE to account for cost-of-service risk and that both customers and the Company benefit from addressing this risk. Id. at 3. PGE claims that not adopting the Company's proposed power cost framework would impose "cost-of-service risk" on the Company, and that "[c]ost of service risk imposed on PGE requires compensation, including an ROE that recognizes this risk . . . ." Id. at 2-3. Under PGE's flawed cost-of-service risk concept, however, customers are just as much at risk that the Company's power cost forecast will exceed actual costs and that PGE will retain the difference. See id. at 35. According to PGE's reasoning, the Commission should somehow "compensate" customers for this risk in the absence of some power cost recovery mechanism, yet PGE proposes no such compensation in this proceeding, just as neither customers nor the utility have ever been compensated for this "risk" in the past. PGE's proposed power cost framework is not designed to mitigate cost-of-service risk; it is designed to shift the risk of power cost variation to customers and benefit the Company.

2. PGE Should Follow the OPUC's Current PCA Policies

ICNU urges the Commission to deny the requests to approve a PCA for PGE until the Company acknowledges the OPUC's PCA policies and proposes an appropriate mechanism. Long-term PCAs have been unusual for Oregon electric utilities over the past 30 years and having such a mechanism should be a privilege, not a right. The Commission should not impose on customers a PCA that is likely to benefit PGE, when the Company refuses to propose a mechanism that acknowledges OPUC policy. If the Commission does adopt a PCA, however, CUB's proposed mechanism appears to be more consistent with Commission policy.

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PGE's proposed PCA ignores the Commission's guidelines for an acceptable PCA regarding power cost recovery, and the Company's opening brief simply states the Company's disagreement with those policies. PGE does not even accept the basic premise underlying most of the Commission's recent decisions, which is that the utility should bear the risk of normal power cost variation between rate cases. OPUC Docket No. UM 1071, Order No. 04-108 at 8-9; Re PGE, OPUC Docket Nos. UE 165 and UM 1187, Order No. 05-1261 (Dec. 21, 2005). Similarly, PGE disagrees with the Commission's conclusion that a PCA should only be triggered for unusual events. PGE Opening Brief at 30. Finally, PGE's Opening Brief does not even address certain aspects of the OPUC's policy, such as that a PCA should not apply to direct access customers.

Instead of following the Commission's guidelines, PGE searches for support for the Company's proposals in other states, outdated precedent, and the purchased gas adjustments ("PGA") approved for Northwest Natural Gas Company ("Northwest Natural") and other natural gas local distribution companies ("LDCs"). PGE Opening Brief at 36. PGE's arguments in support of its proposed PCA are irrelevant, inconsistent with the Company's claims regarding other issues, and unconvincing.

a. The NERA Report Does Not Demonstrate That U.S. Utilities Have PCAs with No Deadband

PGE claims that a NERA Economic Consulting study that the Company commissioned demonstrates that "100% of coverage of differences between forecasted and actual NVPC was a common regulatory practice" in the U.S. and that using a "deadband" in such mechanisms is unusual. Id. at 37. The NERA report is largely irrelevant given the Commission's explicit statements regarding PCAs and its unambiguous conclusion that a

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deadband is the best way to address the normal range of power cost variation that the utility bears between rate cases. OPUC Docket No. UE 165, Order No. 05-1261 at 9. Furthermore, in light of the evidence demonstrating PGE's influence over the conclusions in allegedly "independent" research reports, ICNU considers a report that PGE commissioned to be dubious at best. Nevertheless, even disregarding those shortcomings, the NERA report simply does not support the Company's conclusion about uniform national coverage of PCAs with no deadbands.

PGE generally ignores the statements in the NERA report that contradict the Company's claims. The NERA report states that both Arizona and Colorado utilize some type of deadband, but the Company attempts to explain away these conclusions by arguing that the report was referring to a different concept. ICNU/115, Falkenberg/1. Furthermore, PGE has no explanation for the fact that the Washington Utilities and Transportation Commission ("WUTC") has approved PCAs that include deadbands. The WUTC recently reauthorized Avista's PCA, and that mechanism includes a $4 million deadband, 50/50 sharing from $4 to $10 million, and 90/10 sharing above $10 million, even though Avista's total Washington power costs are less than $125 million. Re Avista, WUTC Docket No. UE-060181, Order No. 03 at ¶ 1 (June 16, 2006); ICNU/103, Falkenberg/39. PGE's proposed power costs, on the other hand, exceed $850 million. ICNU/103, Falkenberg/39. A $4 million deadband for Avista is comparable to approximately $27 million for PGE, and the 50/50 sharing band used for Avista in Washington would be comparable to nearly $70 million for PGE. Id.

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Puget Sound Energy ("PSE") also has a PCA with a $20 million deadband and multiple sharing bands.[1/] Id. Sharing bands in PSE's mechanism start at 50/50. Id. Finally, no other electric utility in Oregon has a PCA. PGE is simply incorrect about uniform coverage across all states of PCAs with no deadbands, and the Company's proposed PCA is dramatically out of sync with the PCAs in place for other Northwest utilities.

b. The Commission Should Ignore the Outdated Precedent Cited by PGE

PGE claims that the Commission's PCA policy should reflect the PCA that the OPUC approved for PGE in 1979, despite the fact that the Commission's PCA policy has evolved substantially since that time. PGE Opening Brief at 36. PGE claims that its 1979 PCA included no deadband, and the Company urges the Commission to adopt this type of mechanism again in this proceeding. Id. At the same time, however, one of PGE's primary arguments is that power costs have become much more volatile in recent years and that a comprehensive power cost framework is necessary to address power cost variation. Id. at 32-33. Furthermore, PGE fails to note that the 1979 PCA included a cap that limited the total rate increase under the mechanism to 0.4 cents/kWh in any three-month period. ICNU/114, Falkenberg/10. This cap effectively places a more restrictive limitation on cost recovery than a deadband. Finally, the Commission sharply criticized the PCA concept in general when it terminated the 1979 PCA, and stated that "PGE's system characteristics are not so unique that a power-cost adjustment clause is necessary." Re PGE, OPUC Docket Nos. UE 47 and UE 48, Order No. 87-1017 at 33 (Sept. 30, 1987).

[1/] The deadband and sharing mechanism in PSE's PCA are currently under review in PSE's pending rate case. Re PSE, WUTC Docket Nos. UE-060266 and UG-060267, PSE Opening Brief at ¶¶ 4-36 (Oct. 31, 2006).

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c. Precedent Regarding PGAs Does Not Apply to PGE

PGE also reasons that the Commission should reject the PCA deadband concept, because PGAs do not include a deadband. The Company claims that its "NVPC are very similar to the gas costs of Oregon's LDCs, particularly [Northwest Natural], where purchased gas costs in Docket UG 152 represented 57% of its overall revenue requirement as compared to the 50% of revenue requirement comprised of NVPC for PGE." PGE Opening Brief at 36.

As CUB and Staff point out, PGE is not a natural gas utility. CUB/200, Jenks-Brown/10-11; CUB/300, Jenks-Brown/23; Staff Opening Brief at 17. The Company's investment in generation assets is a significant distinguishing factor. Id. In fact, it is ironic that PGE seeks to be treated like an LDC at the same time that the Company seeks to include a new large generation resource in rate base. By increasing generation rate base, PGE looks less, not more, like an LDC. As a result, PGE's arguments about LDCs are irrelevant.

Ignoring the relevancy issue, however, PGE's arguments about Northwest Natural are not even consistent. PGE claims in the PCA context that it deserves a PGA-like mechanism because, similar to Northwest Natural's purchased gas expense, NVPC comprise a large percentage of PGE's revenue requirement. In the cost of capital context, however, PGE objected to Staff using Northwest Natural as a proxy to reduce PGE's cost of debt because Northwest Natural is a utility "with which PGE bears little or no resemblance." PGE Opening Brief at 8.

B. Net Variable Power Cost Forecast

PGE fails to convincingly rebut ICNU's net variable power cost ("NVPC") adjustments. PGE does not explain why it should retain the benefit of the extrinsic value of the Company's thermal generating facilities, or how the Company's capacity tolling contracts are

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"necessary" for furnishing electric service. Moreover, PGE inadequately supports its suggestion that the Commission use a four-year rolling average to calculate forced outage rates in this case.

1. PGE Fails to Sufficiently Address Mr. Falkenberg's Extrinsic Value Adjustment

ICNU power cost witness Randy Falkenberg proposed multiple alternatives to reflect the extrinsic value of PGE's generating facilities, but PGE attacks only one of Mr. Falkenberg's alternative approaches in its opening brief. Id. at 46. In direct testimony, Mr. Falkenberg used the historical spreads for Mid-Columbia market electric and gas prices based on Intercontinental Exchange day-ahead prices for the period from June 2002 to June 2006 to calculate his primary extrinsic value adjustment. ICNU/103, Falkenberg/7. In surrebuttal testimony, Mr. Falkenberg accepted some of PGE's mathematical corrections, which reduced his extrinsic value adjustment to $5.9 million, but otherwise stood by his proposal. ICNU/108, Falkenberg/11-12.

Mr. Falkenberg also addressed the reasons why his extrinsic value adjustment is more conservative than Staff's. Mr. Falkenberg attributes this disparity to two reasons: 1) Staff's use of data from the western power crisis; and 2) his conservative assumption that the mean spread will equal the Monet model spread. Id. at Falkenber/12-13; Staff/200, Wordley/12-13. To address those issues, Mr. Falkenberg created two alternatives: Alternative 1, which PGE addresses, used updated data from PGE's most recent Monet runs producing an extrinsic value adjustment of $4.3 million. Alternative 2 used data based on historical spreads producing an extrinsic value adjustment of $5.9 million. ICNU/108, Falkenberg/13. Mr. Falkenberg did not, however, abandon his original methodology discussed in his direct testimony. Rather, the alternative calculations were simply provided to lend support for Mr. Falkenberg's proposed

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adjustment. Although PGE's focuses on Mr. Falkenberg's alternative extrinsic value adjustment in its opening brief, the Company does not address Mr. Falkenberg's main proposal. PGE Opening Brief at 46. As a result, the Commission should adopt a $5.9 million adjustment to account for extrinsic value.

2. Acknowledgement of the Capacity Tolling Contracts in PGE's Least Cost Plan Does Not Guarantee Recovery in Rates

PGE argues that the cold snap and super peak contracts should be included in rates simply because the contracts were acknowledged in the Company's least cost plan. Id. at 47. PGE misconstrues the acknowledgment of its plan. "Acknowledgement of a plan means only that the plan seems reasonable to the Commission at the time the acknowledgment is given . . . . [F]avorable rate-making treatment is not guaranteed by acknowledgment of a plan." Re Investigation into Least-Cost Planning for Resource Acquisitions by Energy Utilities in Oregon, OPUC Docket No. UM 180, Order No. 89-507 at 11 (Apr. 20, 1989).

In LC 33, the Commission acknowledged the acquisition of 400 MW of tolling capability for peak purposes. Re PGE, OPUC Docket No. LC 33, Order No. 04-375 at 13 (July 20, 2004). The Commission did not approve the specific contracts at issue and it specifically stated that the acknowledgement did "not constitute a determination on the ratemaking treatment of any resource acquisitions . . . ." Id. at 12. Based on multiple years of experience with the cold snap and super peak contracts, the contracts have not proven "necessary" to serve customers. See ICNU Opening Brief at 28-30. The contracts have only been dispatched for a few hours over the past two years, and the benefit of the reduced power costs as a result of the contracts has flowed to PGE while customers are stuck with the fixed cost. Id.; ICNU/103, Falkenberg/18-21. PGE once again expects that the contracts will not dispatch in 2007. ICNU/103, Falkenberg/18.

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Forcing customers to continue to pay for contracts that provide no customer benefit is inequitable and unreasonable.

3. PGE Fails to Address How the Four-Year Rolling Average Methodology Gives the Company any Incentive to Improve Plant Reliability

PGE relies heavily on a 1984 Staff memorandum describing the basis for using a four-year average to calculate forced outage rates to support the Company's suggestion to use that methodology in this case. PGE's argument is similar to its claims regarding its 1979 PCA: what was reasonable in the 1980s is reasonable today. The high outage rates at certain PGE generating facilities in the last five years have revealed flaws in using a four-year rolling average based on the utility's plant operation. ICNU, CUB, and Staff all propose using National Electric Reliability Council ("NERC") outage data to address one of the four-year average's primary flaws: the lack of any incentive for utilities to improve plant maintenance and operations. PGE's opening brief provides no argument on this point.

PGE claims that this focus on the forced outage rate methodology is merely a reaction to the recent Boardman outages, but the Company is the one that has raised this issue by both requesting a deferred account for the outage costs (UM 1234) and including the outage in normalized forced outage rates. PGE essentially has tried to force the Commission's hand to allow recovery of certain outage costs one way or the other and, in doing so, has exposed flaws in using a four-year average. Reviewing the significant forced outage rates for PGE generating facilities such as the rate for Colstrip in 2002 has confirmed that flaw.

The Boardman outage is inappropriate to include in forced outage rates. The Company has claimed the outage was extraordinary and there has been no prudence determination. ICNU, Staff, and CUB all support using an alternative methodology that relies on

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objective data compiled by NERC, and adopting a method that uses independent, objective data will eliminate the need for prudence determinations in establishing future forced outage rate assumptions. Furthermore, such a method creates an incentive for the utility to improve plant maintenance and operation, because normalized power costs set in future proceedings will not incorporate the effects of previous poor performance. Similarly, if PGE is able to operate its plants with better than average reliability, it will reap the benefits.

a. ICNU Did Not Agree to NVPC Based on Any Particular Methodology in Previous Proceedings

PGE argues that ICNU is taking inconsistent positions by objecting to including the 2002 Colstrip outage rate in the calculation of forced outage rates in this proceeding, while ICNU consented to NVPC using a four-year average that included the 2002 Colstrip rate in prior proceedings. Id. PGE specifically identifies previous RVM dockets and PacifiCorp's latest rate case, UE 179. Id.

ICNU, CUB, Staff, and PGE resolved all of the previous RVM proceedings except UE 139 by comprehensive, all-party settlements, and the stipulation in each proceeding included a provision to the effect that "no Party shall be deemed to have approved, admitted or consented to the facts, principles, *methods* or theories employed by any other Party in arriving at the terms of this Stipulation." E.g., Re PGE, OPUC Docket No. UE 172, Order No. 05-1140, Appendix A at 4 (Oct. 25, 2005) (emphasis added). PGE's claim that ICNU and Staff "stipulated to rates in three RVM dockets that included 2002 in calculating the four-year average" contradicts the plain language of the stipulations. PGE Opening Brief at 44.

PGE also ignores that the Company made the RVM proceeding vastly more complicated and controversial by proposing numerous model changes and other NVPC

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adjustments each year. Indeed, the Commission had to clarify the scope of the RVM proceedings after the first year, and the parties subsequently agreed to limit the potential changes to the Monet model. Re PGE, OPUC Docket No. UE 139, Order No. 02-772 at 6 (Oct. 30, 2002); Re PGE, OPUC Docket No. UE 149, Order No. 03-535, Appendix A at 3-4 (Aug. 29, 2003). Given the numerous adjustments that PGE proposed in the annual RVM update, it is not surprising that all of the appropriate adjustments to NVPC may not have been made or even proposed in prior cases or that parties discover new issues each year.

PGE claims that ICNU's position with respect to the 2002 Colstrip outage rate in UE 179 is inconsistent with ICNU's position in this case. PGE Opening Brief at 44. However, PGE is mistaken about ICNU's position in UE 179. In that case, Mr. Falkenberg recommended a prudence disallowance for all outage rates, including Colstrip, which resulted in a proposed 7.7% reduction to Colstrip's forced outage rates. ICNU/108, Falkenberg/18.

b. Initiating a Generic Policy Investigation Will Have Little Value if PGE Disregards the Commission's Policies

PGE recommends as an alternative that the Commission initiate a generic policy investigation regarding the appropriate forced outage rate methodology rather than adopting the method that ICNU, Staff, and CUB support. PGE Opening Brief at 44. PGE's suggestion is curious, given the Company's unwillingness in this case to follow the Commission's policy on the PCA issues. The Commission provided clear guidelines regarding an appropriate PCA in UE 165, but PGE disregarded those guidelines in fashioning its proposed PCA, and it criticized those guidelines in its testimony and briefs. PGE's suggestion to initiate generic policy discussions falls flat in light of the Company's response to other recent policy decisions.

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C. Cost of Capital

PGE attempts to justify the Company's cost of capital proposals by raising the specter of a credit rating downgrade. PGE Opening Brief at 6. PGE argues that such action would increase its cost of capital and leave it "with a very small cushion above non-investment grade in the event PGE incurs adverse financial impacts." Id. The Commission should not be swayed by PGE's scare tactics. PGE presented no evidence to support its speculation that there is any legitimate risk of a credit rating downgrade. Moreover, as PGE acknowledges, the Company's ratings currently are comfortably above non-investment grade status. Id. In the unlikely event of a downgrade, PGE would merely have less "cushion" above non-investment grade status. PGE also has done little to show that the benefit of a higher credit rating outweighs the cost.

PGE's cost of capital arguments fail due to two fundamental flaws: 1) the Company failed to provide sufficient evidence to demonstrate that the Company is comparatively riskier than the other utilities Mr. Gorman's proxy group; and 2) PGE assumes away any impact of Enron ownership. The Commission requires credible evidence to support its cost of capital decisions, and the unsupported opinions of PGE employees that the Company is a riskier investment is not such evidence. Furthermore, although PGE may want to forget Enron ownership, the Commission cannot do so in setting the Company's cost of capital. Enron had a direct and identifiable impact on PGE's equity ratio and cost of debt, and the Company has explicitly agreed in OPUC-approved stipulations to hold customers harmless from increases in capital costs and revenue requirement due to Enron ownership. See Re Enron, OPUC Docket

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No. UM 814, Order No. 97-196, Appendix A at 2 (June 4, 1997); OPUC Docket Nos. UF 4218 and UM 1206, Order No. 05-1250, Appendix A at 4.

1. Capital Structure

a. PGE's Proposed Capital Structure Is "Unreasonable"

PGE's primary argument in response to ICNU and CUB's proposed capital structure improperly latches on to Mr. Gorman's statement that his proposal is "more reasonable" than the Company's. PGE Opening Brief at 16. PGE argues that decisions of courts and commissions in Maine and Maryland show that ICNU and CUB must demonstrate that the Company's proposal is "unreasonable" rather than simply offering a "more reasonable" alternative. Id.

Determining the appropriate capital structure is not a battle of adjectives. PGE's proposal is unreasonable. ICNU-CUB/300, Gorman/1. A capital structure that includes excess equity accumulated because PGE lost access to capital during the Enron bankruptcy and suspended dividend payments to preserve liquidity is unreasonable. Id. at Gorman/13. A capital structure that unnecessarily inflates the utility's proposed rate of return and increases revenue requirement for customers is unreasonable as well. Id. at Gorman/12. PGE's proposed capital structure suffers from both of these flaws.

PGE once again selects standards from distant jurisdictions and attempts to impose those rules in Oregon. Regardless of whether PGE's strategy is appropriate or convincing, the Maine Supreme Court case that PGE cites actually confirms that a capital structure with the types of defects that Mr. Gorman identified is "unreasonable." The Maine court stated that adopting a more reasonable capital structure is appropriate "when the utility's

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actual debt-equity ratio may be deemed to be inefficient and unreasonable, because it contains too much equity and not enough debt, thereby necessitating an inflated rate of return . . . ." PGE Opening Brief at 16 (quoting New England Tel. and Tel. Co. v. Public Util. Comm'n, 390 A.2d 8, 39 (Me. 1978)). Mr. Gorman recommended rejecting PGE's proposed capital structure for this specific reason. ICNU-CUB/300, Gorman/1 ("The Company's projected capital structure is overweighted with common equity and therefore is too expensive and unreasonable for rate setting purposes."). ICNU and CUB have met the Maine standard that PGE seeks to impose.

b. The Commission Should Adjust PGE's Capital Structure to Remove the Effects of Enron Ownership and Reflect PGE's Expectations

PGE also complains that Mr. Gorman's conclusion that the excess equity was due to Enron ownership is "backward looking" and unsupported by evidence. PGE Opening Brief at 17. Mr. Gorman's adjustment does look back to Enron ownership, but that is because PGE has committed to protect customers from increases in cost of capital and revenue requirement associated with that ownership. See OPUC Docket No. UM 814, Order No. 97-196, Appendix A at 2; OPUC Docket Nos. UF 4218 and UM 1206, Order No. 05-1250, Appendix A at 4. PGE agreed as a condition in the Enron merger that "the allowed return on common equity and other costs of capital will not rise as a result of the merger." OPUC Docket No. UM 814, Order No. 97-196, Appendix A at 2. Furthermore, PGE agreed in the recent stock distribution proceeding "not to seek recovery of increases in the allowed return on common equity and other costs of capital . . . due to Enron's ownership of PGE . . . " and "not to seek recovery of increases in PGE's revenue requirement that result from Enron ownership of PGE." OPUC Docket Nos. UF 4218 and UM 1206, Order No. 05-1250, Appendix A at 4. These broad and unambiguous conditions, which are backed by the force and effect of two Commission orders, protect

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customers from any increased cost resulting from PGE's equity-rich capital structure. Even in the absence of these conditions, the Commission could not simply "stick its head in the sand" as PGE suggests and hold customers responsible for the costs of Enron ownership. Such costs are unreasonable to include in prospective rates.

PGE's claim that the record lacks evidence to support the connection between the current high equity ratio and Enron ownership is patently incorrect. PGE Opening Brief at 17; see ICNU Opening Brief at 39-41. To the contrary, the record contains substantial evidence that demonstrates that PGE's equity ratio increased when the Company lost access to capital following the Enron bankruptcy and Enron suspended PGE's dividend obligations allegedly to help maintain liquidity. ICNU Opening Brief at 39-41. After PGE's equity ratio ballooned to approximately 59%, it then decreased once Enron emerged from bankruptcy. PGE paid a "catch up" dividend to Enron, and the Company began issuing debt once again. ICNU-CUB/300, Gorman/13; Staff/1400, Morgan/4; Staff/1200, Conway/9-15; Staff/1201, Conway/33. PGE's own exhibit PGE/1113 confirms the rise and fall of the Company's equity ratio during Enron ownership. Although PGE's equity ratio has now fallen from its highest point, the current 53% equity ratio nevertheless reflects the lingering effects of Enron's ownership. Mr. Gorman's proposed capital structure seeks to remove those effects.

In contrast to PGE's complaint about ICNU's approach being backward looking, PGE argues that Staff's evidence of the Company's future capital structure assumptions is too forward looking. See PGE/2700, Hager-Valach/9-10. According to PGE, Staff's evidence of the Company's assumptions for its capital structure in 2007 reflects the Company's "long run"

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expectations. Id. PGE seeks to limit the Commission's consideration to only the current actual capital structure by preventing the Commission from looking too far forward or backward.

The evidence demonstrates that PGE expects to have a 50% common equity ratio. Staff/1400, Morgan/6; Staff/1402, Morgan/67. PGE's responses to Staff's data requests state that PGE plans to manage its capital structure to achieve a 50% common equity ratio over the period 2007-2010, and PGE's internal planning reflects the same assumptions. Staff/1400, Morgan/6; Staff/1403, Morgan/26. The rates set in this case could be in place for many years, particularly if the Commission adopts any portion of the proposed power cost framework. The cost of capital set in PGE's last rate case, UE 115, has been in effect for more than five years. As a result, it is appropriate to set the equity ratio at a level that PGE expects to achieve over time.

c. PGE Provides No Support for the Claim That Mr. Gorman's Proposed Capital Structure Will Not Maintain PGE's Credit Ratings

PGE acknowledges in its opening brief that Mr. Gorman appropriately tested his proposed capital structure by considering the impact of off-balance sheet debt equivalence in calculating the three primary financial ratios that S&P uses to evaluate a company's total credit risk. PGE Opening Brief at 15. Nevertheless, PGE states for the first time in this proceeding that the Company disagrees with Mr. Gorman's conclusion that his proposed equity ratio and ROE will maintain the Company's current credit ratings. Id. at 17. PGE offers no support for this conclusion in its brief. See id. Furthermore, PGE's witnesses did not disagree with Mr. Gorman's conclusion that the Company's total adjusted debt ratio under his proposals fell in the middle of S&P's acceptable range for a company with PGE's bond rating and business risk profile score. See PGE/2000, Hager-Valach/64-66. The only PGE testimony responding to

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Mr. Gorman's proposed capital structure consists of oblique, unsupported statements by PGE employees that "Company-specific" issues require the additional equity. Id. at Hager-Valach/65; PGE Opening Brief at 17. These claims do not address Mr. Gorman's verification that his proposed capital structure is sustainable based on S&P's financial ratios. PGE/2000, Hager-Valach/65; PGE Opening Brief at 17.

PGE's opening brief identifies funding capital expenditures, maintaining liquidity, and unresolved litigation as the relevant PGE-specific concerns that justify a higher equity ratio, but these concerns apply to most utilities. PGE Opening Brief at 17. PGE also identifies SB 408 as a risk. Id. As ICNU demonstrated in its opening brief, however, PGE's claim is at odds with its claims that it will be relatively unaffected by SB 408 after the end of Enron ownership. ICNU Opening Brief at 55. PGE has failed to demonstrate that Mr. Gorman's proxy group does not provide a reasonable representation of PGE's risk.

2. Return on Equity

a. PGE Has Failed to Justify Adopting a ROE Other Than the Mid-Point of a Properly Calculated Range

The ROE discussion in PGE's opening brief primarily focuses on the Company's disagreement with Staff. PGE disagrees with little about Mr. Gorman's analysis and calculations, and most of PGE's criticisms of Staff's analysis are inapplicable to Mr. Gorman. Mr. Gorman developed a proxy group that PGE accepted, relied on multiple models as PGE suggests, and calculated a range of results that PGE does not dispute. PGE nevertheless disagrees with Mr. Gorman's selection of the 9.9% mid-point of his range of results for his ROE recommendation rather than choosing a point at the upper end of his range to reflect all of PGE's allegedly "Company-specific" risk. PGE Opening Brief at 21-22.

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PGE's ROE recommendation fails for lack of credible supporting evidence. ICNU Opening Brief at 51-53. PGE's primary support for selecting a ROE estimate at the upper end of the Company's calculated range is statements by PGE employees that they relied on "judgment and experience" to determine that PGE-specific risk justified a 10.75% ROE. PGE/1100, Hager-Valach/39. PGE did not quantify this allegedly Company-specific risk to justify selecting an estimate at the upper end of the Company's range. Moreover, PGE did not provide evidence to convincingly demonstrate that it was qualitatively different from the proxy group of comparable utilities that Mr. Gorman used. Unsupported speculation by PGE employees that the Company is more risky than the proxy group provides no basis for the Commission to accept that conclusion. PGE must relate its employees' opinions that Company-specific risk justifies a higher ROE to some credible evidence in the record. PGE established no such relationship in this case.

PGE's opening brief focuses heavily on the parties' various discounted cash flow ("DCF") analyses. PGE Opening Brief at 21-25. The average ROE for the utilities in Mr. Gorman's proxy group under his DCF analysis was 9.5%, based on a range of 7.38% to 12.58%. ICNU-CUB/306, Gorman/1. PGE argues that had Mr. Gorman relied upon his full range of results and "developed a point estimate based on PGE's unique characteristics compared to the sample group, a figure closer to PGE's 10.75% would have been suggested." PGE Opening Brief at 21-22. The Commission and the other parties have no way to test PGE's claim, however, because PGE provided no verifiable means to duplicate the Company's selection of its ROE estimate. PGE employees have simply repeated time after time that the Company is subject to more risk and chosen a higher number. Without any evidence to qualitatively or quantitatively

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demonstrate that PGE is subject to more Company-specific risk than other utilities, using the mid-point is appropriate. ICNU explained in its opening brief why the risks that PGE used to justify its recommended ROE are either generic risks that all utilities bear or otherwise illegitimate. ICNU Opening Brief at 53-57.

b. The "Other Information" That PGE Provides Does Not Justify a Higher ROE

PGE also urges the Commission to consider "other information" in adopting an appropriate ROE. PGE Opening Brief at 25. PGE provided evidence that indicates that the average ROE adopted for electric and combination utilities since January 2005 is 10.47%. Id. at 26. The Commission stated in UE 115 that it would not base an ROE award for a utility on ROEs authorized in other jurisdictions, but that it may use such information to gauge the reasonableness of results from independent methodologies. Re PGE, OPUC Docket No. UE 115, Order No. 01-777 at 34 (Aug. 31, 2001). The average ROE from PGE's survey of other jurisdictions merely reflects the top end of the 9.5% to 10.4% range on which Mr. Gorman relies for his recommendation. This only confirms the reasonableness of Mr. Gorman's calculations. It provides no basis to adjust PGE's ROE upward from the mid-point of a properly determined range. In addition, authorized ROEs from as far back as early 2005 do not provide an accurate forecast of required returns during 2007.

PGE also provides a stipulation from Colorado in which parties agreed to a 10.5% ROE, a 60% common equity ratio, an overall rate of return of 8.85%, and some type of PCA. PGE Opening Brief at 26. PGE's claim that the terms of this stipulation "confirm the reasonableness of PGE's proposals in this case" is absurd. Id. at 27. The Colorado Public Utilities Commission has not even approved this stipulation so there is no basis to conclude that

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the results are reasonable. Furthermore, a stipulation from another state with regulations and specific circumstances that the OPUC, Staff, PGE, and intervenors know nothing about is not compelling or persuasive. Although the Commission previously found that a survey of ROE decisions could potentially help to confirm that independently derived results are reasonable, an unapproved settlement from another state provided without context deserves no weight. PGE ignores the precedent that arguably is the most relevant—the Commission's approval of a stipulated 10.0% ROE for PacifiCorp in Dockets UE 170 and UE 179. Re PacifiCorp, OPUC Docket No. UE 170, Order No. 05-1050 at 10 (Sept. 28, 2005); Re PacifiCorp, OPUC Docket No. UE 179, Order No. 06-530 at 4 (Sept. 14, 2006).

3. Cost of Debt

PGE unconvincingly opposes Staff's cost of debt adjustment. The Company once again seeks to dismiss the impact of Enron ownership, but the Commission cannot do so. PGE's claims that the credit rating downgrade that it experienced following the Enron bankruptcy had nothing to do with Enron's dramatic collapse simply are not credible. Regardless of the ultimate cause of PGE's additional costs related to Enron, forcing customers to bear those costs is inappropriate and violates the orders approving the "hold harmless" conditions described above.

Another provision in the stock distribution stipulation also helps protect customers. PGE, Staff, ICNU, CUB, and other parties negotiated a commitment that required PGE to maintain a minimum common equity ratio of 48% plus an additional $40 million. OPUC Docket Nos. UF 4218 and UM 1206, Order No. 05-1250, Appendix A at 4-5. PGE agreed to "maintain this additional $40 million during the pendency of PGE's next general rate to assure PGE's financial capacity to absorb adjustment(s), if any, in PGE's revenue requirement resulting

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from" enforcing the conditions that hold customers harmless from increases in costs of capital or revenue requirement due to Enron's ownership of PGE. Id. In other words, Staff and intervenors anticipated that adjustments to capital costs and revenue requirement would be necessary to remove the impact of Enron ownership and required PGE to set aside $40 million of the excess equity that the Company did not dividend to Enron following the bankruptcy in order to fund the adjustments proposed in this case. The Commission should give effect to those conditions in this proceeding in order to protect customers from the increased costs of Enron ownership.

III. CONCLUSION

For the reasons stated above and in ICNU's opening brief, ICNU recommends that the Commission: 1) reject PGE's proposed power cost framework; 2) adopt ICNU's proposed adjustments to PGE's NVPC forecast; and 3) adopt ICNU and CUB's capital structure and ROE proposals, along with Staff's adjustment to PGE's cost of debt.

Dated this 1st day of December, 2006.

Respectfully submitted,

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