BEFORE THE PUBLIC UTILITY COMMISSION

OF OREGON

UE 197

In the Matters of PORTLAND GENERAL ELECTRIC COMPANY Request for a General Rate Revision	**PORTLAND GENERAL ELECTRIC COMPANY'S REPLY BRIEF**

Tonkon Torp LLP
888 SW Fifth Avenue, Suite 1600
Portland, Oregon 97204
503-221-1440

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Tonkon Torp LLP
888 SW Fifth Avenue, Suite 1600
Portland, Oregon 97204
503-221-1440

Tonkon Torp LLP
888 SW Fifth Avenue, Suite 1600
Portland, Oregon 97204
503-221-1440

I. INTRODUCTION

We agree with the other parties in this docket that PGE has the burden of proof. We take that responsibility seriously. We have filed over 643 pages of testimony, 133 exhibits, and responded to almost 1,000 data requests not including electronic worksheets. Our request is built from the "bottom-up," justifying each new project and worker needed to offer safe, reliable, and efficient service to our customers during the 2009 test year. We don't rely on speculation, out-dated information or over-generalizations to forecast the needs of our system and our customers. We determine what it will take to operate the system during the test year and forecast the cost associated with that operation. That is how we satisfy our burden of proof: project-by-project, worker-by-worker.

The parties opposing our request take a different tact. Notwithstanding their mantra that we have not met our burden of proof, they complain that the evidence is too detailed and supported by actual departmental budgets. They say the case is too focused on "the underbrush" (CUB Opening Brief at 11) or our "bottom up" budget process. (ICNU Opening Brief at 10.) They ask the Commission to ignore real-world conditions during the test year, inviting the Commission to engage in speculation, such as:

- assume PGE can cut 1% from its revenue requirement without any evidence that substantial cuts can be made without undermining service quality and reliability,
- assume historic information and trends will continue while ignoring direct evidence that the future will impose new requirements and obligations; and
- assume PGE has no cost control measures in place even though (i) no one can point to significant additional discretionary programs to cut and (ii) the absence of easy cuts suggests just the opposite.

Tonkon Torp LLP
888 SW Fifth Avenue, Suite 1600
Portland, Oregon 97204
503-221-1440

We embrace the burden of proof the other parties say is placed upon us. It is a reminder of what this and other rate cases are supposed to be about. Test year service conditions that will continue into the future and the cost of such service, not wishful thinking that the future imposes no new obligations or that major cuts can be made without reducing service quality and harming the financial strength of the utility.

The remainder of this reply brief is organized as follows:

- Section II rebuts CUB's proposal to cut 1% of PGE's entire revenue requirement;
- Section III addresses workforce related adjustments in this docket (adjustment to the number of FTEs, wages and salaries, incentives and loadings);
- Section IV discusses distribution O&M and customer service issues;
- Section V focuses on plant and generation O&M matters;
- Section VI addresses compensation related issues;
- Section VII analyzes A&G expenses still in dispute;
- Section VIII reviews the remaining tax related items; and
- Section IX sets forth PGE's position with respect to pricing issues (Staff's seasonal pricing proposal, low income issues, and decoupling).

II. THE COMMISSION SHOULD REJECT CUB'S PROPOSAL TO CUT 1% OF PGE'S ENTIRE REVENUE REQUIREMENT

CUB continues to request that the Commission make a 1% reduction of PGE's entire revenue requirement. (CUB Opening Brief at 43.) This proposed reduction is not linked to anything allegedly imprudent or any unnecessary cost identified by CUB. Rather, it is based on CUB's generalized suspicion that PGE must have some imprudent costs somewhere that CUB and the other parties have simply failed to identify.

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888 SW Fifth Avenue, Suite 1600
Portland, Oregon 97204
503-221-1440

As PGE pointed out in its Opening Brief, CUB is essentially asking the Commission to first examine test period costs to determine fair, just and reasonable rates, and then make a further downward adjustment unconnected to any specific finding about any specific cost. This is inconsistent with the general policy that the Commission must allow a utility the opportunity to recover prudently incurred operating expenses. (*See* UE 115, Order No. 01-988 at 5 (Nov. 20, 2001).)

In its Opening Brief, CUB argues that PGE is misstating CUB's argument by focusing on O&M costs. CUB argues that it simply wants PGE to take a 1% deduction on its entire revenue requirement, but that as far as CUB is concerned, PGE can take those cuts anywhere.

CUB misses the point of PGE's argument. CUB's specific allegations of imprudent expenses relate almost exclusively to O&M costs. This is because the great majority of PGE's revenue requirement, comprised of power costs, cost of capital, depreciation and amortization, and taxes and fees (except property taxes) has either been settled or is undisputed. O&M expenses account for only a small portion of this request and only about 20% of PGE's total revenue requirement. (PGE/2200, Piro/6.) CUB has identified some allegedly imprudent expenses – which even CUB acknowledges are "not large," (CUB Opening Brief at 39) – and from those specific examples argues for a 1% reduction across PGE's entire revenue requirement, including the 80% that is not in dispute here. Viewed in relation to the disputed items, this proposed reduction is of much greater magnitude than CUB suggests.

The larger problem with CUB's argument is that it depends entirely on a logical fallacy. CUB alleges that it has found a handful of imprudent expenses which it concedes are "not large." From this, CUB asks the Commission to infer that there must be other, large items of imprudent expense that CUB has simply failed to uncover. CUB's failure to find large items

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888 SW Fifth Avenue, Suite 1600
Portland, Oregon 97204
503-221-1440

of imprudent expense cannot be taken as evidence that such large items exist. It is the opposite of evidence for that proposition.[1]

CUB seeks to make up for the lack of evidence by referring in general terms to the increase in PGE's total revenue requirement. (*See*, e.g., CUB Opening Brief at 9.) What CUB fails to acknowledge, however, is that almost two-thirds of this entire increase is related to increased power costs and 80% is undisputed. Accordingly, the increase should not be seen as evidence of some sort of persuasive lack of cost control in PGE's O&M costs.

CUB tries to link its claims of "not large" imprudent O&M expenses with its general statements about increases in PGE's revenue requirement. From this, CUB apparently hopes that the Commission will infer that these revenue-requirement increases are somehow related to the minor expense items that it has identified. But it would be improper and illogical to draw this connection. The vast majority of the increase in PGE's total revenue requirement is already explained on this record by corresponding increases in power costs. It should not be taken as evidence of mysterious imprudent O&M expenses that CUB has yet to discover.

In the same vein, CUB asks the Commission not to focus on the "underbrush," but rather on the "big picture." (CUB Opening Brief at 10-11.) By "underbrush," CUB apparently means the actual items of expense from PGE's budget that it has identified. By "the big picture," CUB apparently means unsupported arguments about PGE's internal cost controls. The problem is that "underbrush" is all that CUB has presented to the Commission; these minor items of allegedly imprudent expense are the totality of CUB's substantive case.

It is not unreasonable to expect CUB to come forward with evidence of the pervasive excesses it alleges. The Commission should proceed based on the actual content of

[1] In fact, Staff conducted a detailed review of PGE's actual transactions from 2007 and found only small amounts as part of their miscellaneous A&G and O&M adjustments (S-9) that they specifically characterize as "discretionary." (*See* Staff/300, Ball-Daugherty/14-15, 21.) In addition, CUB complains that PGE was able to identify only one discretionary capital job in its 2009 capital budget. (*See* CUB/200, Jenks/31 and CUB Opening Brief at 45.) Yet, CUB cannot identify any other discretionary or imprudent projects from the lengthy list of PGE capital jobs provided as CUB Exhibit 216.

Tonkon Torp LLP
888 SW Fifth Avenue, Suite 1600
Portland, Oregon 97204
503-221-1440

the record, rather than on CUB's rhetoric and leaps of logic. CUB is asking the Commission to disallow unspecified items of expense without any evidence or argument that those items are imprudent.

III. WORKFORCE – RELATED ADJUSTMENTS SHOULD BE REJECTED

A. The other parties' exclusive reliance on historic data is inconsistent with Commission policy and should be rejected.

We agree with ICNU's statement that the central issue in this case concerns whether wages and other employee related costs should be based upon (i) PGE's estimate of the activities and programs needed to provide safe and reliable service during the test year 2009 or (ii) historic information alone. (ICNU Opening Brief at 9.) PGE's testimony described its budgeting process, the primary drivers for the increase in FTEs for the test year 2009, and the basis for each incremental FTE. (*See, e.g.*, PGE/1400, Tooman-Tinker/7-10.) The other parties have not disputed this evidence. Instead, they rely on the principle that the test year must be based on actual historic information and historic trends only. (ICNU Opening Brief at 9-10.) They ask the Commission to ignore actual company budgets used to forecast test year conditions. (*Id.*)

The other parties' position cannot be squared with the Commission's practice and policies. Staff's preference for actual historic data alone is simply not supported by Commission orders. Indeed, the Commission expressly uses "future test years" which may be derived from historic or forecasted data:

> A test year is a forward-looking representation of the first year when rates will be in effect. It should present prospective recurring costs and revenue relationships that will fairly represent the period when rates from the docket will be in effect. It should comply with Commission orders and policies, as well as state and federal laws. It should contain relationships that will not substantially change as customers or access lines increase or decrease. It can be based on **historic**, **future**, or **forecast data**. [emphasis supplied.]

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888 SW Fifth Avenue, Suite 1600
Portland, Oregon 97204
503-221-1440

In re United Telephone Company of the Northwest dba Sprint. (UT 155, Order No. 03-382, Appendix A at 7 (June 30, 2003).)

While the source of rate case information may be either historic or forecasted data, the purpose of the test year is to represent *expected* operations during the rate period and the costs associated with such operations. The notion that the Commission should ignore budgets in determining the costs of providing service during the test year defies common sense and established ratemaking principles. (*American Can Co. v. Lobdell*, 55 Or App 451, 454-55 (1982) ("When a future test year is used, the data is drawn from budget figures and financial models of the utility."))

In fact, ICNU and CUB ignore conditions that will apply during the test year period and focus instead on the past. This approach is strikingly similar to the position ICNU and CUB advanced in UE 115. There, ICNU sought to cap PGE's O&M expenses based on historic actual levels escalated by anticipated customer growth and inflation. (UE 115, Order No. 01-777 at 8.) As in this case, PGE developed its UE 115 forecasted revenue requirement using traditional ratemaking principles, starting with budgeted information and adjusting those figures to remove nonrecurring events. (*Id.*) The Commission expressly adopted PGE's approach while rejecting the backward-looking approach ICNU and CUB sponsored:

> We also reject CUB's and ICNU's inflation-escalator proposals as independent methods to establish non-power O&M costs for PGE. Consistent with established Oregon rate making principles, PGE's test year should be based on actual or budgeted expenditures and adjusted to remove abnormalities and to include known and measurable changes that are expected to persist. The parties' respective inflation benchmark proposals are not appropriate for evaluating PGE's expenditures, because the methodologies do not examine the reasonableness of historical operations, fail to consider abnormalities in the base line years results of operation and do not take into account known and measurable changes between the baseline and test year, such as the passage of SB 1149.

(*Id.* at 9.)

Nor do the orders upon which ICNU relies withstand review. ICNU cites an order from UT 125 for the proposition that "as a general rule, actual data is preferable to forecasted data". (ICNU Opening Brief at 8.) In fact, that decision is diametrically opposed to ICNU's backward-looking rule. In that case, the Commission said that "the issue here is not whether actual data are preferable to forecasted data." (UT 125, Order No. 00-191 at 96 (April 14, 2000).) Instead, the Commission rejected US West's attempt to rely on actual data submitted so late in the case that it could not be verified. (*Id.*) The Commission expressly disavowed addressing the issue ICNU claims it decide and rejected actual data in favor of rate case forecasts. It's hard to imagine a case less favorable to a backward-looking approach.

Finally, ICNU's reliance on the Commission's order in a PacifiCorp rate case is ill founded. (ICNU Opening Brief at 8 citing Order No. 01-787.) The Commission decision in that case was based on a different record involving a different utility, and concerned a completely different request for wages and salaries and other related items.

ICNU seeks to distract from the real issues in dispute by suggesting that "none of the parties have had the opportunity to thoroughly review that budget to understand the underlying assumptions and calculations." (ICNU Opening Brief at 10.) ICNU and the other parties in this proceeding have had more than an adequate opportunity to thoroughly review PGE's forecast and budget. PGE has responded to approximately one thousand data requests in this docket, which has included multiple workshops, two rounds of testimony for Staff and interveners, a hearing, and now two rounds of briefs. Intervenors efforts have also been supported by intervenor funding. If this proceeding has not afforded the parties an adequate opportunity to review a utility's request, then no process possibly can.

As we stated in our opening brief, the Commission should reject the backward-looking formulaic approaches Staff, CUB, and ICNU endorse. However, to the extent actual historic results are deemed paramount and forecasts of test year conditions discounted for

Tonkon Torp LLP
888 SW Fifth Avenue, Suite 1600
Portland, Oregon 97204
503-221-1440

determining FTEs, the Commission should use the alternative PGE described in sursurrebuttal testimony, which used the most recent actual data available and avoided the controversy surrounding "conversion hours." (*See* PGE Opening Brief at 11-12; PGE/2300, Tooman-Tinker/15.)

B. Staff's approach uses the wrong FTE assumptions

Staff proposes a reduction of 98 FTEs from PGE's request with an associated $11.2 million cost adjustment. Staff starts from an estimate of actual 2007 FTEs, escalates that number by a growth rate, and then compares the result to PGE's initial FTE request. All of the flaws in Staff's proposed FTE adjustment are described in PGE's opening brief on pages 9-12.

In its opening brief, Staff continues to use the wrong figure for baseline year 2007. (Staff Opening Brief at 4.) The correct actual FTE figure for 2007 is 2,612, contained in PGE's 2007 Results of Operations Report. (PGE/1400, Tooman-Tinker/8.) PGE regrets that it initially provided an incorrect figure when it first provided actual 2007 FTEs. But this is no excuse for Staff's position that it will use the uncorrected figure even after PGE corrected the figure in both rebuttal and sursurrebuttal testimony. (PGE/1400, Tooman-Tinker 8; PGE/2300, Tooman-Tinker/10-11.) ICNU and CUB have accepted PGE's revised figure for 2007 actual FTEs. Indeed, Staff's growth rate for FTEs is based upon PGE's revised figure for 2007 actual FTEs. Staff and the Commission should use PGE's corrected 2007 figure consistently for both the growth rate and the 2007 baseline.

Aside from using the wrong starting point for its analysis, Staff fails to update PGE's request to reflect PGE's current position. As discussed in PGE's testimony and its opening brief, PGE initially forecasted 2,733 FTEs (not including non-exempt overtime). We subsequently included a number of adjustments reducing the number of forecasted FTEs to 2,706. The principal adjustment was the elimination of 30 FTEs from PGE's request to reflect the average level of unfilled vacancies. (PGE/1400, Tooman-Tinker/7-10.) Without any basis in

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888 SW Fifth Avenue, Suite 1600
Portland, Oregon 97204
503-221-1440

the record, Staff takes the position in briefs that PGE's initial forecast of 2,733 FTEs already included this 30 FTE reduction made during the case. (Staff Opening Brief at 5.) This is just wrong. PGE's rebuttal testimony graphically showed that PGE reduced its initial request from 2,733 to 2,706 FTEs, including the 30 FTEs for unfilled vacancies:

Table 1
Adjustments to 2009 FTEs

Original 2009 FTEs	2,733
Removed four FTEs associated with PGE's heat pump program so it is not included in rates	-4
Removed 20 distribution FTEs as unfilled positions (offsetting credit included)	-20
Removed 10 customer service representative FTEs as unfilled positions (offsetting credit included)	-10
Added seven FTEs to meet additional FERC/NERC/WECC compliance requirements	+7
Adjusted 2009 FTEs	2,706

(PGE/1400, Tooman-Tinker/10.)

Staff and the other intervenors attempt to create a diversion by claiming confusion regarding the different FTE figures used in this case. (Staff Opening Brief at 3-4; ICNU Opening Brief at 11.) This is a smokescreen, not a legitimate complaint. In rebuttal and sursurrebutal testimony, PGE explained the different FTE figures used in this case and how each was derived. (*See, e.g.,* PGE/1400, Tooman-Tinker/6-10; PGE/2300, Tooman-Tinker/8-13.) PGE has consistently used the same numbers for FTE in its rebuttal and sursurrebuttal testimony. (*Id.*) ICNU's claim that PGE has been inconsistent with respect to FTEs is simply wrong. (ICNU Opening Brief at 11.) The differences ICNU identifies reflect nothing more than FTEs with and without paid overtime. The difference between these FTE totals was clearly identified in all instances and FTEs representing paid overtime were not contested by the other parties (except ICNU in Opening Briefs – *see* below). This reflects legitimate differences based upon different standards, not inconsistency or misrepresentation, as ICNU suggests.

As we discussed in our opening brief, proper implementation of Staff's approach would yield an adjustment of 18 FTEs. We do not support Staff's approach. However, if done

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888 SW Fifth Avenue, Suite 1600
Portland, Oregon 97204
503-221-1440

correctly, Staff's approach should result in a $2 million reduction to PGE's labor costs, not Staff's proposed $11.2 million cost reduction. (PGE/1400, Tooman-Tinker/10, PGE Opening Brief at 9-11.)

C. ICNU-CUB's workforce, wages and salary, and payroll-related adjustments are unpersuasive and should be rejected

ICNU seeks to interject into this proceeding a number of new factual claims and adjustments that are unsupported in the record and that seek to supplement the record. For example, ICNU proposes new adjustments for payroll expense, benefits and incentives, and overtime that substantially diverge from its witness' testimony in this proceeding. (*See* ICNU Opening Brief at 9 and Exhibit 1 to ICNU Opening Brief.) Moreover, ICNU refers to anecdotal evidence regarding current economic conditions that was never introduced into the record in this proceeding, much less subject to review, discovery and rebuttal. (*See* ICNU Opening Brief at 17.) ICNU fails to seek permission to file such material after the record has been closed. Accordingly, the Commission should reject ICNU's revised request with respect to these matters given that it relies on factual claims outside the record. The Commission should limit its decision to ICNU's testimony and exhibits provided during this proceeding, which are part of the record. The final order should not rely upon new factual claims contained in briefs that have not been subject to discovery or rebuttal testimony or evidence.

1. <u>ICNU–CUB's adjustment to the number of FTEs should be rejected</u>

ICNU claims confusion regarding how FTEs are calculated. (ICNU Opening Brief at 13.) PGE has been clear on how FTEs are calculated for rate making purposes all along. An FTE represents approximately 2,080 hours of work.[2]

[2] For more detail on FTE calculations, *see* PGE Exhibit 2300, page 10. FTEs do not reflect employees or head count because FTEs represent hours over time and employees represent people at a point in time. Instead, FTEs reflect the level of effort needed to perform PGE's regulated activities. (PGE/1400, Tooman-Tinker/6.)

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888 SW Fifth Avenue, Suite 1600
Portland, Oregon 97204
503-221-1440

We are puzzled by ICNU's statement that "exempt overtime hours should not be converted to FTEs." (ICNU Opening Brief at 12.) "Exempt employees" are employees who are exempt from payment of overtime under the Fair Labor Standards Act. PGE's Opening Brief and testimony addressed why it is appropriate to convert those hours over 2,080 for exempt employees (or "conversion hours," as we call them), when calculating the total number of FTEs for rate making purposes. (*See* PGE Opening Brief at 10-11; PGE/2300, Tooman-Tinker/10-12.) ICNU has no basis upon which to complain about PGE's use of conversion hours – i.e., using exempt overtime hours to calculate test year FTEs. Ms. Blumenthal uses the figure of 2,612 FTEs for the 2007 baseline figure, an amount that is based on conversion hours. (*See* ICNU-CUB/111, Blumenthal/7.)

ICNU's complaint regarding PGE's over budgeting for FTEs is similarly ill-founded. (ICNU Opening Brief at 12-13.) In advance of parties raising the issue that PGE historically has a certain number of unfilled positions, PGE removed 30 FTEs to reflect the historic average of such unfilled positions. (PGE/1400, Tooman-Tinker/14-15.) Accordingly, ICNU's concern has already been addressed.

ICNU's position on the number of FTEs continues to lack evidentiary support. As pointed out in PGE's opening brief, Ms. Blumenthal used a "plug" escalation rate of one percent to forecast test year FTEs. Ms. Blumenthal offers no explanation or support for this escalation rate. It bears no relationship to the historic growth rates in the tables accompanying Ms. Blumenthal's testimony. ICNU's Opening Brief graphically demonstrates this fatal flaw. For base 2007 actual FTEs, ICNU acknowledges that this figure should be 2,612. (ICNU Opening Brief at 14.) However, it calculates the escalation rate to apply to this figure using a different basis than its reply testimony and one that was unexplained and unverifiable in its surrebuttal testimony. ICNU's unsupported theory should be rejected.

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ICNU's proposal also contains several errors. For example, ICNU overstates the adjustment by double counting officer wages. PGE's test year request of 2,706 FTEs includes officers. (*See* Hearing Transcript at 53.) Yet, ICNU inflates its adjustment amount by adding officer wages again when it states the amount of PGE's request. (Exhibit 1 to ICNU's Opening Brief between lines 3 and 4.) ICNU is also wrong when it states that PGE is requesting \$221,372,069 in wages and salaries. (ICNU Opening Brief at 16 (citing ICNU Exhibit 119 at 2).) At the hearing, Mr. Tooman testified that ICNU Exhibit 119 did not reflect the revenue requirement in the case because it double counted officer wages. (Hearing Transcript at 56.)

2. <u>ICNU's wage adjustment arbitrarily ignores historical data and relies instead on unverified anecdotal information</u>

PGE's pay structure is determined by the relevant markets in which PGE competes for labor. PGE routinely compares its wages and salaries to what comparable companies pay to ensure that PGE offers competitive market wages and salaries. (PGE/800, Barnett-Bell/6.) As pointed out in our Opening Brief, Ms. Blumenthal uses an arbitrary method to forecast increases in PGE's wages and salaries. She selectively removes certain data from her analysis when it contradicts or does not support the predetermined outcome. (PGE Opening Brief at 14-15.)

ICNU's position that officer compensation is "out of control" is simply unfounded. In 2006, PGE hired an outside, independent third-party expert, Watson Wyatt, to conduct a market analysis. (Hearing Transcript at 22.) This third party expert reviewed surveys, such as the *Towers Perrin Executive Survey*, as well as 14 similar companies and other market data. (*Id.*) This analysis showed that PGE officers were compensated *well below market*. As a result, officer compensation was increased to bring them to just below, not above, market:

> Basically they determined what the ranges of salaries should be, the mid points, and our executives were brought from well below the market to almost market. For example, Peggy Fowler went from the 25th percentile to the 39th. (Hearing Transcript at 23.)

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ICNU relies on anecdotal material (ICNU Exhibits 124, 125 and 126) regarding other local utilities that is thoroughly unpersuasive. (ICNU Opening Brief at 22.) First, there is no testimony or record evidence supporting or explaining this material. There is no testimony or evidence describing how the compensation information was compiled. ICNU introduced this raw data at the hearing affording no opportunity to review, verify, or rebut such material. ICNU submitted two rounds of written testimony and their expert never offered, supported, or mentioned this information. The PGE witness to whom ICNU showed the exhibits had no personal knowledge of the material. Hearing Trans. at 27-30.

Second, the material ICNU relies on includes information regarding PacifiCorp, which is no longer part of PGE's comparative group after its acquisition by Mid American. (Hearing Transcript at 29.) Third, the list of officers included in the material ICNU cites is not comparable to the PGE officers in this rate case. Fourth, PGE draws its executives from national markets, not just the local market, which is the exclusive source of ICNU's exhibit. (Hearing Transcript at 29.) Finally, ICNU has failed to produce an objective, systematic market study. Instead, it has pulled off-the-shelf anecdotal information that does not compare to the systematic, objective and market oriented evidence in this docket that shows that PGE's officer compensation is below market and supports PGE's 2009 forecast.

3. <u>ICNU's overtime adjustment is without any support in the record</u>

ICNU proposes for the first time, an adjustment to PGE's overtime wages request. (ICNU Opening Brief at 17.) ICNU's theory, unsupported with any references to testimony for the record, is that overtime should be reduced as the number of FTEs is reduced. There is no basis for ICNU's assumption in the record or in logic. Indeed, the opposite inference is more likely. With fewer employees to do to the work, overtime hours may in fact increase. In any event, PGE determines the amount of overtime wages in its request based upon budgets from individual departments. (*See* PGE/1300, Piro/29.) This amount is included in the rate case

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888 SW Fifth Avenue, Suite 1600
Portland, Oregon 97204
503-221-1440

request, and no party has previously objected to this component of PGE's request. Overtime requirements are driven by any number of factors, including outages and storms, which do not conveniently occur during normal weekday working hours. Accordingly, ICNU's adjustment should be rejected.

4. ICNU's method of adjusting the payroll loadings rate overstates adjustment amounts

ICNU continues to be confused about the use and application of payroll loadings. As we discussed in our Opening Brief, the payroll-related costs that these loadings represent (payroll taxes, employee benefits, incentives and employee support) are not included in this case through application of the loadings rate. Instead, each amount is directly forecasted. The loadings rates are then a derivative of these costs and not vice versa. (PGE Opening Brief at 12, 18-19.) Accordingly, adjustments for payroll-related costs should be made directly and not through a loadings rate adjustment, as ICNU does. (ICNU Opening Brief, Attachment 1.)

ICNU's approach of removing such costs through a loadings rate adjustment significantly overstates the adjustment amount even after their attempted corrections in Exhibit 1 of ICNU Opening Briefs. This is because ICNU continues to assume incorrectly (i) that the loadings rate drives the revenue requirement request and (ii) that payroll-related costs change as a direct function of payroll.[3]

To give just one example, PGE's benefits expenses are forecasted directly in its request. ICNU, on the other hand, forecasts benefits based on the application of a loadings rate to labor costs. (*See* ICNU Opening Brief, Attachment 1.) Therefore, any reduction in labor costs reduces benefits costs under ICNU's model. In fact, most benefit expenses do not vary based on total labor costs. The majority of ICNU's payroll adjustment is based on its claim that wages should be reduced. (*See* ICNU Opening Brief, Attachment 1.) This reduction in wages will have

[3] PGE's allocation methodology is clearly defined, has been audited by the OPUC Staff, has been authorized in numerous rate cases, and is provided annually as part of PGE's Affiliated Interest filing. (PGE/1400, Tooman-Tinker/17-18.)

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888 SW Fifth Avenue, Suite 1600
Portland, Oregon 97204
503-221-1440

no effect whatsoever on medical benefits costs, which are based on the number of employees and the selections they are expected to make for insurance coverage (e.g., employee only, employee with spouse, employee with family). ICNU is simply wrong on the whole notion of loadings and how to use them.

5. ICNU's Employee Support Adjustment Is Unjustified

ICNU claims it has no objection to including employee support at the level included in UE-180 rates. (ICNU Opening Brief at 19.) Yet, ICNU makes an adjustment by removing employee support from the loadings rate without adding back these costs anywhere else. This generates a $5.7 million reduction in PGE's revenue requirement request with no means for PGE to recover these costs, notwithstanding ICNU's position that it would support employee support at UE-180 levels.

As we mentioned in our Opening Brief, ICNU's only objection to employee support -- that employee support costs do not vary with payroll and therefore should be removed from the loadings rate -- misses the point. (PGE Opening Brief at 14.) PGE directly forecasts employee support costs in its rate case. PGE then allocates the support costs across various activities but it does not use the loadings rate to derive or support its revenue requirement request.

ICNU's argument that PGE has counted employee support costs twice again derives from its misunderstanding of how we use payroll loadings. (ICNU Opening Brief at 19.) Employee support costs are forecasted directly under A&G. (PGE/500, Piro-Tooman/2.) That is the only place such costs are included in PGE's request. PGE does not use the loadings rate to generate yet another figure for employee support costs as ICNU suggests.

It does not matter that employee support is labor intensive and therefore included in the total number of FTEs, as ICNU suggests. (ICNU Opening Brief at 19.) These costs are forecasted and included directly in the revenue requirement. They are then divided by the

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888 SW Fifth Avenue, Suite 1600
Portland, Oregon 97204
503-221-1440

appropriate labor base to derive a payroll loading rate, which is used to allocate some of those costs to capital. (PGE/2300, Tooman-Tinker/19.) That allocation does not in any way lead to double counting of such costs. In fact, it removes costs from A&G and allocates them to capital projects and "below the line."

D. The other parties' arbitrary disallowance of 50% of PGE's non-officer incentives should be rejected

None of the parties in this proceeding dispute that PGE's non-officer incentive programs align compensation with customer benefits. Indeed, because the incentive plans are aligned "toward customer benefit" Staff increases the amount it would otherwise support. (Staff Opening Brief at 7.) However, Staff's and other intervenors' reliance on Commission Orders Nos. 99-697 and 99-333 as a starting point is misplaced. The Commission's prior policy as articulated in those orders was targeted specifically at benefit plans that "are generally focused on the company's increased earnings and, therefore, bring more benefits to shareholders." (Order No. 99-697 at 44.)

PGE's incentive plans are neither focused on shareholder benefits nor divorced from our customers' interests. Rather, the incentive plans are designed specifically to ensure that incentive payments dovetail with customer benefits. As such, PGE's incentive plans in this case bear no resemblance to the officer compensation plans that were the subject of the Commission's policy in the 1980s and 1990s. More recent Commission orders offer more support for a change in policy. In UE 115 (Order No. 01-777), the Commission allowed 85% of PGE's non-officer incentives. (PGE Ex. 2402.) In UE 180 (Order No. 07-015), the Commission allowed 75% of PGE's non-officer incentives. (PGE Ex. 2403.)[4]

The other parties' response to this recent trend is to argue that we can't cite those orders. They claim that PGE agreed not to use the stipulations in those cases "as precedent in future cases." (ICNU Opening Brief at 20.) We rely not on the stipulations themselves but

[4] If 75% of non-officer incentives were allowed, this would result in a revenue requirement adjustment of approximately $2.1 million. (PGE/2400, Barnett-Bell/10.)

Tonkon Torp LLP
888 SW Fifth Avenue, Suite 1600
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rather on the Commission's decision adopting rates that included 85% and 75% of the non-officer incentive plans in those cases. The terms of the stipulations in UE 115 and UE 180 left the parties free to cite the final order in those dockets. Moreover, the Commission has used final orders adopting stipulations as guiding precedent (as have the parties that complain about the practice in this docket). To name just one example, the Commission's policies with respect to power cost deferrals and power cost adjustment mechanisms over the last several years were founded upon the Commission orders adopting stipulations during the 2000-2001 power crisis in dockets UM 1008-1009. (UM 1071, Order No. 04-108 at 9 (March 2, 2004); UE 165, Order No. 05-1261 at 9 (Dec. 12, 2005).) Parties in those power cost proceedings liberally cited the Commission's final order in UM 1008-1009 even though the stipulations contained the exact same prohibition against citing the stipulation as precedent in future cases. We seek nothing more in relying on the final orders in UE 115 and UE 180. The Commission should follow its more recent precedent, not the outdated policy upon which Staff and other parties rest their case, and approve the inclusion of non-officer incentive plans as a reasonable component of PGE's compensation costs.

In addition to its proposed 50% disallowance of non-officer cash incentive plans, Staff now seeks to disallow 100% of the Stock Incentive Program (SIP) for non-officers. (Staff Opening Brief at 7.) PGE voluntarily removed the cost of the SIP for officers; however, no party submitted testimony or opposing the program for non-officers. Staff now claims its testimony was in error and that, contrary to its testimony, it meant to remove not just the officer SIP but the SIP in its entirety. *Id.* Whatever Staff intended in testimony, it is left with the record it created. That record provides absolutely no testimony supporting removal of the entire SIP. PGE has the right to conduct discovery, file rebuttal testimony, and conduct cross examination of witnesses on testimony. Parties have the opportunity to file errata to testimony while the record is open. Permitting a party to change its testimony after the record is closed deprives us of those rights

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and our right to a decision on the factual record, not a record the parties meant to create and now seek to amend in briefing.

Moreover, the SIP is an important component of PGE's compensation plan and provides customer benefit by promoting retention of employees (*See* PGE/800, Barnett-Bell/10-11; PGE/1500, Barnett-Bell/12.) Staff and ICNU's proposed adjustment to remove the SIP for non-officers ($1.1 million) should be rejected.

IV. DISTRIBUTION O&M AND CUSTOMER SERVICE

A. The Commission should reject Staff's proposal to reduce PGE's tree-trimming costs

Staff continues to recommend that the Commission reduce PGE's tree-trimming costs by approximately $1.3 million. This recommendation is based entirely on a misunderstanding caused by PGE's initial, erroneous response to OPUC Data Request No. 428. In that initial response, PGE mistakenly stated that it would trim approximately 4,500 line miles in 2008 and 2009. PGE has since corrected that response to reflect the accurate estimate of 4,112 miles. (PGE/2500, Hawke/6-7; PGE Ex. 2501). As explained in PGE's sursurrebuttal testimony, this correction does not reflect any change in PGE's tree-trimming plans; in other words, PGE is not planning to reduce its tree-trimming by 388 miles. Rather, PGE is correcting a double-counting error in its original response. (*Id.*)

PGE based its original $12.3 million request on the estimated amount of equipment and number of crews needed to meet PGE's tree-trimming responsibilities in 2008 and 2009. These include both the 4,112 miles of scheduled trimming that PGE has projected and other vegetation maintenance services not included in that schedule. (PGE/1600, Hawke/7-8).

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PGE's $12.3 million request was not based on the erroneous 4,500 mile estimate given in response to OPUC Data Request No. 428. Rather, it was based on PGE's actual trimming schedule and other projected vegetation maintenance. But that erroneous estimate is the sole basis for Staff's proposed reduction. Staff's recommendation is that, since PGE's estimated line-miles have "decreased" by 388, there should be a corresponding decrease in PGE's tree-trimming budget. But the budget was not based on the erroneous estimate; in fact, there has been no "reduction" in the schedule that was the basis for PGE's budget request. The only basis for Staff's proposed reduction was an error, since corrected, in PGE's sursurrebuttal testimony.

The proposed cut would not, as Staff suggests, reduce PGE's proposed tree-trimming budget to the appropriate level. Instead, it would reduce it below the level necessary to perform scheduled tree-trimming and other services. (PGE/2500, Hawke/6-7.) PGE regrets that its initial response to OPUC Data Request No. 428 was incorrect, but that response has been corrected and should not be the basis for an unjustified reduction in the budget for a necessary and mandated service.

B. PGE proposes to reduce underground fitnes costs by $900,000 based on a change from a four-year cycle to a ten-year cycle

Staff opposes PGE's plan to move Underground FITNES costs from a four-year to a ten-year cycle, even though this adjustment would result in a greater reduction of PGE's revenue requirement in this rate case. Staff does not appear to dispute PGE's point that a ten-year cycle is standard for other electric utilities in Oregon. (PGE/2500, Hawke/8.) There is no testimony opposing this change, and Staff's briefing offers no principled reason to distinguish PGE from Oregon's other electric utilities in this respect. The Commission should approve PGE's request to change to a ten-year cycle for Underground FITNES, together with the resulting reduction in PGE's costs for the program.

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C. The Commission should reject Staff's proposed reduction to the porcelain insulator replacement project

As with Staff's proposed reduction of locating costs, Staff's proposed $288,000 adjustment to PGE's porcelain insulator replacement project would leave PGE unable to adequately staff the project. Staff's proposed adjustment, for contract labor costs, fails to take into account that PGE expects to fully utilize its labor work force in addition to taking on these additional contract labor costs. Accordingly, the proposed savings that Staff envisions will not be realized. Accepting Staff's proposal to reduce contract employees on the porcelain insulator replacement project will leave PGE understaffed to complete this important project. (PGE/2500, Hawke/3.)

The flaw in Staff's argument stems from Staff's insistence on looking only at non-labor costs of this project. The 2007 actual expenses of the project reflect work by both PGE employees and contract labor. Staff disregards employee costs in comparing actual 2007 and projected 2009 costs, with the result that it escalates only a portion of PGE's work costs for the project, those related to contract labor. There is no basis for Staff's decision to ignore the expense of those employees in its 2009 calculations. The result of this error is a significant understatement of PGE's real projected costs for the porcelain insulator replacement project in 2009. This erroneous reduction would compromise PGE's ability to stay current on this project, and the Commission should not adopt it.

D. The Commission should reject Staff's proposal to deduct locating costs

In its Opening Brief, OPUC Staff repeats its argument for deducting approximately $271,000 from locating costs for the 2009 test year. Staff acknowledges that it bases its recommendation on PGE's response to Data Request No. 183, and further acknowledges that that Data Request asks for non-labor costs only. (PGE/2500, Hawke/4.)

As with the porcelain insulator replacement project, Staff's failure to account for labor costs causes a serious misstatement of PGE's real locating costs. Here, again, PGE uses a

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combination of employees and contract labor for locating services. Indeed, some locating services can only be performed by qualified employees. (PGE/2500, Hawke/4.) When all costs of locating are considered, Staff's proposed adjustment is significantly too high. Staff also fails to address PGE's projected increase in locating expenses. (PGE/2500, Hawke/5-6). Staff's failure to address labor costs and projected increases results in a proposed adjustment that would leave PGE with a significant cost shortfall for locating expenses. The Commission should not support this result.

E. The Commission should reject CUB's proposal to remove costs of the customer focus initiative

CUB asks the Commission to disallow the entire $300,000 cost of the Customer Focus Initiative. The Customer Focus Initiative is a modest program designed to enhance PGE's customer service. The purpose of this initiative is to serve customers better and to enhance reliability across PGE's operations. Responsiveness to customers and improving efficiency are reasonable and prudent goals for a public utility. This initiative furthers those goals for a modest cost. The $300,000 expense of this customer-focused program is reasonable and prudent, and the Commission should reject CUB's effort to strip it from PGE's request.

As with Generation Excellence (discussed below), CUB's attack on the Customer Focus Initiative demonstrates its short-sighted view of PGE's operations. These programs are designed to help customers by improving customer service and operations at PGE's generation facilities, thereby reducing outages and increasing efficiency, reliability and safety. That CUB has chosen to focus on these programs, which even CUB admits are not large components of PGE's revenue requirement, indicates that CUB places minor short-term savings ahead of long-term quality and customer service. This is not PGE's approach, and it should not be the Commission's approach either. Safety, reliability, and customer service are not trivial aspects of PGE's operations. The modest cost of these initiatives is more than justified by their long-term benefits to customers.

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V. PLANT AND GENERATION O&M

A. The Commission should reject CUB's proposal to remove all generation excellence costs

CUB asks the Commission to disallow all costs related to Generation Excellence. (CUB Opening Br. at 26.) Generation Excellence is a program focused on the continued training of skilled personnel of PGE's generation facilities. This effort is crucial and will benefit customers through decreased outages and improved service. (PGE/2600, Quennoz/4.) The benefits of properly trained personnel at generation facilities are obvious and central to PGE's mission, notwithstanding the fact that no formal cost-benefit analysis of this particular initiative has been performed. CUB's argument to the contrary is unpersuasive.

CUB also argues that it is irrelevant that Generation Excellence costs will largely be non-incremental in 2009. (CUB Opening Brief at 29.) But it is clearly relevant that PGE took on a significant portion of the Generation Excellence expense prior to the test year for this rate case, even though that expense would be unrecoverable. CUB claims elsewhere in its brief that PGE is indifferent to cost savings because PGE generally only incurs costs it can recover from customers. But PGE has shown its commitment to this initiative by incurring significant Generation Excellence expenses in 2008, despite the fact that those expenses are unrecoverable. The incremental costs of Generation Excellence in 2009 are justified by the obvious benefit of having highly trained, highly qualified staff at PGE's generation facilities. (PGE/1800, Quennoz/2-6).

B. The Commission should reject CUB's proposed removal of costs for Revision II of the Boardman Simulator

The Commission should also reject CUB's proposal to deny costs for the Boardman simulator. As with Generation Excellence, the simulator is a training component necessary to maintain and improve the quality of operations at PGE's generation facilities. (PGE/2600, Quennoz/6.)

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CUB continues to fault PGE for not conducting a separate cost-benefit analysis to accompany each increase in cost of the Boardman simulator. Although PGE has conducted one cost-benefit analysis of the simulator, the primary justification for the simulator has always been reliability, not cost savings. (*Id.*) This is a training tool, designed to improve safety and reduce outages in PGE's increasingly complex generation facilities, thereby lowering power costs over the long term. Although there are undoubtedly will be short-term economic benefits from improved training, in the form of decreased costs for off-site training and decreased cost of outages, these are not the primary justifications for the simulator. Since the simulator was first proposed, its primary justification has been reliability, which lowers power costs in the long term, and it is inappropriate for the Commission to decrease PGE's request for the simulator based on CUB's arguments about cost-benefit analyses.

C. The Commission should approve PGE's proposed creation of a regulatory asset for O&M costs for Beaver, Boardman and Colstrip plants

None of the parties dispute that PGE will incur substantial O&M costs for its Beaver, Boardman, and Colstrip generating plants in the test year 2009. (PGE/2200, Piro/10.) The only question is whether PGE will be allowed to recover those costs. By permitting PGE to recover only the nominal value of its prudently incurred costs over a ten-year period, Staff would affectively disallow a substantial portion of these costs without any claim that the costs are imprudent or unnecessary.

Staff's opening brief makes no new arguments for effectively disallowing a substantial portion of PGE's costs. It alludes to "administrative issues" associated with PGE's proposal without explaining what "administrative issues" could possibly apply to the routine creation of a regulatory asset. (Staff Opening Brief at 17.)

The Commission should adopt PGE's proposed treatment for O&M costs associated with Beaver, Boardman and Colstrip generating plants. That proposal strikes an appropriate balance between the desires to mitigate rate increases with the recognition that PGE

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should recover its prudently incurred costs. Staff's proposal is inadequate in that it fails to consider the time value of money and insures that PGE will not recover its true costs. While PGE recommends a five-year regulatory asset structure, it is willing to support a 10-year regulatory structure so long as it is permitted to recover the time value of costs incurred in the test year.

VI. COMPENSATION RELATED ISSUES

A. The Commission should reject Staff's proposed reduction to medical and dental benefits

Staff proposes removing $660,585 from PGE's request for medical and dental benefits. As discussed in PGE's surrebuttal testimony (PGE/2400, Barnett-Bell/12), Staff's proposed escalation rate of 8.5% for premiums is too low. Active union medical and dental costs are a negotiated benefit and are managed by a Taft-Hartley trust. PGE anticipates that these costs will increase at a rate similar to the increase for non-union medical and dental benefit costs, or approximately 10% annually. (PGE/1500, Barnett-Bell/15-16.)

Staff also incorrectly concludes that escalation of 2009 test year medical and dental benefits should only be applied to 10 months of the year, rather than 12 months. But, as PGE explained in our response to OPUC Data Request 419, PGE Exhibit 2404, PGE's union agreement requires it to make contributions above and beyond the fixed annual contribution if the "trust determines that there are not sufficient funds to ensure the viability of benefits for active employees covered by the collective bargaining agreement." Irrespective of the timing of a new collective bargaining agreement, medical and dental costs for active union employees are expected to rise 10% annually from the 2007 actual expense. The 10% projected 2009 increase will take effect at the beginning of 2009, not two months later. Regardless of the date of PGE's new union agreement, PGE will be responsible under its existing agreement to make increased contributions for 12, not 10, months of 2009.

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When those misunderstandings in Staff testimony are corrected, the justification for Staff's proposed adjustment disappears. A table setting out the appropriate adjustments and full requirement is set out at PGE/2400, Barnett-Bell/13. No reduction is appropriate, and PGE should be granted the full amount of this request.

B. The Commission should approve PGE's request with respect to other benefits

In its opening brief, Staff claims that PGE has been unable to identify the sources for its requests for miscellaneous or other benefits. (Staff Opening Brief at 10.) Staff's argument that PGE "has continually shifted its explanation from one cost driver to another" finds no support in the record. PGE has provided ample justification for these other benefits both in rebuttal and in sursurrebuttal testimony. The drivers for the increased funding PGE is requesting have remained constant throughout its testimony. (*See e.g.*, PGE/800, Barnett-Bell/12-17, PGE/1500, Barnett-Bell/20-24, PGE/2400, Barnett-Bell/14-16; PGE Opening Brief at 29-30.) Staff's proposed adjustment in this area should be rejected.

C. The Commission should reject the proposed adjustment for PGE's long-standing employee discount

We support continuation of the employee discount for our current and future employees. This benefit is part of PGE's total compensation package that helps it to compete for qualified workers in a labor market where its direct competitors (PacifiCorp and Northwest Natural) offer a similar discount. (PGE/2400, Barnett-Bell/18.) The impact of the employee discount is less than $0.9 million in 2009. (PGE/1500, Barnett-Bell/27.)

The parties opposing this program (CUB, ICNU, and CAPO) offer no new support for the elimination of this long-standing program, which many other utilities in Oregon offer. CUB mistakenly claims that we recognize that there are "issues" with the program. (CUB Opening Brief at 21, 53.) We do not. PGE described a phase out alternative approach, not because there are "issues" with the program, but because this alternative would be less harmful

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than the complete elimination of the discount. (PGE/2400, Barnett-Bell/8.) A phase-out would not undermine the bargain made with our retired and current employees and it would do less harm to PGE's ability to retain current employees than would its complete elimination.

VII. A&G

A. The Commission should modify Staff's proposed reduction related to insurance premiums

Staff recommends removing approximately $1.83 million from PGE's projected 2009 insurance premium costs. This reduction is excessive and unsupported in the record.

D & O Insurance: PGE has demonstrated in detail why D&O insurance is a necessary, prudent and ordinary cost of the electric utility business. (PGE/1900, Piro-Tooman 16.) Adequate D&O insurance is a necessary cost of doing business and hiring competent executives and directors, and should be treated as such.

Staff argues that D&O insurance costs should be reduced by 50% because (1) shareholders, rather than customers, vote on slates of offices and directors; and (2) shareholders sometimes file lawsuits against officers and directors. (Staff Opening Brief at 14.) While true, neither of these observations demonstrates that D&O insurance is not a reasonable, ordinary and prudent cost of the public utility business. In fact, these two factual statements apply to most, if not all, investor-owned utilities. Staff does not explain why these facts about directors and officers provide evidentiary support for a 50% reduction in insurance costs. Because these costs are prudent and are an ordinary cost of doing business, they should be allowed in full.

Additional Insurance Policies: Staff incorrectly states that PGE is attempting to "bring in new insurance policies" in its sursurrebuttal testimony. (Staff Opening Brief at 14, citing PGE/2700, Piro-Tooman/4.) In making this argument, Staff simply ignores PGE's Third Supplemental Response to OPUC Data Request No. 66. (*See* PGE Exhibit 2701, 2702C, 2703C.) PGE did not attempt to introduce evidence of these policies in sursurrebuttal, and, in fact these policies were in PGE's initial filing.

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Escalations of Property Insurance Policies: PGE proposed an escalation rate of 9.4% to account for increases in property insurance policy premiums that will occur in 2009. (PGE/2700, Piro-Tooman/8, PGE Exhibit 2074C.) Staff argues that no escalation is appropriate because insurance rates are not expected to increase. (Staff Opening Brief at 15.) But PGE's proposed escalation is not based on any anticipated increase in rates. As PGE pointed out in testimony and in its Opening Brief, the basis for this escalation is the increase in value of the underlying property to be insured. Flat insurance rates can still produce increased insurance premiums when the value of the property being insured increases. That is the case here, and PGE's proposed escalation is therefore appropriate.

Allocation of Insurance Premiums between Utility and Non-Utility Property: Staff proposes to reduce the total amount of PGE's insurance costs downward by 1.79% as an adjustment for premium coverage of both utility and non-utility property. (Staff/900, Ball/15.) PGE has proposed that this downward allocation should only be applied to categories of policies in which non-utility activity may actually be covered. There is no rationale for applying this downward departure to policies that do not apply to any non-utility activity. (PGE/2700, Piro-Tooman/9-10.)

Staff argues that it does not have enough time to consider PGE's proposal or to apply its 1.79% reduction only to those categories of insurance policies that apply to non-utility activities. This is not sufficient justification for applying this reduction to policies that do not apply to any non-utility component. Staff had (and has) adequate time to review PGE's proposal, or to propose refinements to its own approach. The Commission should not adopt Staff's plainly inaccurate approach, but instead should adopt PGE's approach, which actually attempts to differentiate between utility and non-utility components in these insurance policies.

In sum, PGE recommends that the Commission allow $8,549,902 for insurance policies, resulting in a downward adjustment to PGE's filed case of $439,815 allocable 45.5% to capital and 54.5% to O&M. These costs are part of the original rate case and should be part of this analysis. (*See* PGE Exhibit 2707.)

B. The Commission should reject Staff's proposed reductions for miscellaneous charges

Staff's proposes reductions to various miscellaneous charges totaling approximately $710,000. PGE has presented its arguments with respect to these charges in its testimony. (*See* PGE/2700, Piro-Tooman/12-14 and in its Opening Brief at 37-39.) For the reasons stated, PGE respectfully requests that the Commission reject Staff's proposed reduction for miscellaneous costs.

VIII. TAXES

A. Staff's property tax adjustment should be rejected

In surrebuttal testimony, Staff proposed a revenue requirement figure of $34 million for Oregon/Montana property tax expense. Staff's proposed $2 million adjustment to PGE's revised request of $36 million is based on two ill-founded adjustments. First, Staff suggests that the property taxes should be considered a function of plant-in-service, net of depreciation, rather than as a function of overall rate base. (PGE/2300, Tooman-Tinker/20.) This is wrong. In fact, property taxes are dependent on all of the assets of the company, including regulatory assets and liabilities, materials and fuel. (*Id. at* 21.) The Oregon Department of Revenue uses several methods to arrive at an assessed value which determines PGE's property tax expense. One such approach examines the capitalized income of the company. "Since PGE's income is a function of our entire rate base, it follows that property taxes are also a function of all the elements of rate base as well." (*Id.*)

Second, the level of property tax expense proposed by Staff is sufficient only if one assumes the following: (1) tax rates do not increase at all from 2007 to 2009; and (2) there is no increase in assessed value due to capital additions after January 1, 2008. Neither of these assumptions is reasonable. (*Id. at* 21-22.) PGE projects over $191 million in net capital additions by the end of the test year, 2009. These additions increase the assessed value to which the effective property tax rate is applied. Even assuming that property tax rates remain at their 2007 average levels in Oregon, these capital additions would increase the Oregon property tax expense in 2009 by $1.1 million. The property tax expense in Montana would similarly rise by approximately $.1 million. (*Id. at* 23.) These upward adjustments from Staff's forecast do not even include any allowance for increases in the underlying tax rate. Staff's proposed adjustment for property taxes should be rejected.

B. The Commission should set an SB 408 ratio that recognizes disallowed costs

SB 408 requires the Commission to establish certain ratios in general ratemaking proceedings, which are used to determine "taxes collected" from customers for the purpose of the SB 408 true-up of "taxes paid" to "taxes collected." We believe the Commission should consider the impact of disallowed costs in determining the tax rate and margin ratio for SB 408 purposes.

Staff argues that this approach would be inconsistent with SB 408 and the Commission decisions in the SB 408 rulemaking proceeding. We disagree. SB 408 defines "taxes collected" in terms of the effective tax rates and "net to gross" revenue ratio "as determined by the Commission in establishing rates." (ORS 757.268 (13)(e).) Nothing in SB 408 or in the implementing rules prevents the Commission from establishing these ratios in a manner that recognizes the expected profitability of the utility as a result of a general rate case.

The Commission has discretion and the authority to establish ratios that are fair and reasonable. Where the Commission has such discretion under SB 408, it has exercised its authority to avoid unwarranted and unintended consequences.[5] In this case, adjusting the margin ratio to include expenses PGE is either contractually required to incur or for costs that are likely to be incurred, but which costs have been disallowed for ratemaking purposes, is fair and

[5] *See, e.g.*, UM 1234, Order No. 07-227 at 6 (June 8, 2007) ("we note that SB 408 contains no language proscribing the Commission from accounting for SB 408 effects on utility costs when setting rate"); UE 180, Order No. 07-015 at 27 (adjusting a power cost adjustment mechanism to consider SB 408 impacts); AR 499, Order No. 06-532 at 5 (September 19, 2006) (adopting rules for the apportionment of taxes paid between parent company and the utility).

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accurate. If customers are not responsible for paying the underlying expense because of a ratemaking disallowance, they should not be permitted to receive the tax benefit from that expense through SB 408. PGE is not asking the Commission to reverse the effects of its disallowances or to even eliminate the double whammy effect of SB 408. Rather, all we are asking is for the Commission to use the most accurate margin ratio based on the current rate case. Such a ratio is the most accurate measure of the expected profitability for PGE and reflects appropriate ratios "as determined by the Commission in establishing rates." Therefore PGE's proposal should be used for establishing the SB 408 "net to gross" revenue ratio.

IX. PRICING

A. Staff's seasonal pricing option is premature and unwarranted at this time

Staff's opening brief asserts that it is necessary now to implement seasonal pricing. Staff appears to believe that PGE's concerns about customer impacts, implementation and administrative issues are of no concern or consequence. We disagree. When proposing new rate structures and substantial changes to existing rate designs, the precise contours of the proposal are critically important to a successful and sustainable rate structure. Our review of Staff's proposal indicates that more work needs to be done on these proposals and that there is no need for the Commission to rush to a premature and not fully reviewed, new rate structure.

Staff's opening brief spends nearly nine pages attempting to explain its seasonal rate proposal, which in many ways departs from its earlier proposal. Some of these proposed changes are unclear and leave us uncertain as to how the various pieces fit together. This illustrates that the components of Staff's proposal are neither sufficiently developed nor understood by PGE or our customers.

We have raised concerns about the rate design impacts on time of use rates, direct access transition adjustments, and how the rates will be managed over time. (*See* PGE/2000, Kuns-Cody-Lynn/4; PGE/2800, Kuns-Cody-Lynn/5-7.) These concerns have not been answered

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in testimony or in Staff's opening brief. While we do not claim that implementing seasonal rates is impossible or even exceedingly difficult, we believe that Staff's proposal requires further study before it can be implemented. The various customer groups participating in this docket agree with us.

We believe it is unnecessary to rush to the type of seasonal pricing Staff proposes when the summer peak that appears to be the motive force behind Staff's proposal is more than a decade away. It is better to more fully explore the implications of Staff's proposal and to test the impact of that proposal under different scenarios. Staff has not presented any analysis that indicates how their seasonal pricing proposal provides for efficient rate schedule migration or how its proposal affects Schedule 128 transition adjustments for customers that choose market supply options either from PGE or from an ESS. We believe that at a minimum, these requirements should be fully explored before adopting seasonal pricing. The stipulation we reached with ICNU, CUB and Kroger to open a docket in 2009 will enable parties to more fully analyze and develop appropriate proposals.

Staff proposes to change PGE's pricing structure over the objections of PGE and all participating customer groups in this case because the third quarter average on-peak prices are higher than the on-peak prices in other portions of the year as forecasted for 2009. (Staff Opening Brief at 18-19.) However, Staff's updated Exhibit 502, attached to its brief, shows that third quarter on-peak prices are less than $1.50/MWH higher than in the fourth quarter. Furthermore, the overall prices are higher in the fourth quarter than in the third quarter. This hardly provides a basis for the seasonal pricing Staff advocates, especially given their lack of analysis regarding rate migration and transition adjustments. Staff's citation to PGE's IRP is unavailing. (*Id.* at 19.) Staff fails to mention that the projected dual peak (summer and winter peaks) occurs only at the end of the next decade. For the foreseeable future, PGE is projected to be a winter-peaking utility.[6]

Fundamentally, Staff's proposal provides the wrong price signals to customers. Under Staff's proposal, a customer's bill will be higher in the summer, despite the fact that higher overall prices occur in the winter months. This is true not only on a historical basis but for the foreseeable future. The third quarter of 2010 is projected to have lower mid-Columbia hub prices than both the first and fourth quarters. (Staff Cross Examination Exhibit 4).) However, if Staff's proposal is adopted, customers would incur higher bills during a period that is expected to be a lower cost period for the company. Clearly this makes no economic sense and provides inappropriate price signals.

Staff states that only on-peak prices matter, but unfortunately Staff proposes changes to Schedules 32 and 83 when those tariff energy prices are not on-and off-peak differentiated. (Staff Opening Brief at 21.) The result is that these schedules will incur higher bills in the third quarter even though the fourth quarter has higher overall projected energy prices. Indeed, the market price projections for 2010 that Staff cites clearly demonstrate that both the first and fourth quarters contained higher overall prices than the third quarter. (*See id.*; Staff Cross Exmaination Exhibit 304.) This provides perverse price signals to customers.

In addition, the precise contours of Staff's proposal are unclear. For commercial schedules (i.e., Schedules 32 and 83), Staff had proposed a seasonal differential of 1.2 cents per KWH for these non-time-of-use differentiated customers. Now in its opening brief, Staff claims that the differential is less than 1 cent per KWH. (Staff Opening Brief at 20.) As further evidence that Staff's proposals are not fully developed, Staff states that for Schedule 89 they are proposing a "super-peak/off-peak" differential "in the neighborhood of 20 mills with a shoulder-

[6] Staff is either mistaken or misled when it states that PGE's 2006 energy sales, as stated in its FERC Form 1 were higher during the Summer months in 2006. The figures Staff cites include PGE's sales for resale, not native load figures. In fact, PGE's sales to retail customers were highest in the fourth quarter, the second highest sales occurring in the first quarter. The third quarter had the third highest sales.

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peak/off-peak differential at a lower intermediate level." (Staff's Opening Brief at 25.) In its opening testimony, Staff provided Exhibit 504 that included super-peak prices that were either 24 or 25 mills per KWH higher than the off-peak prices. Now we are told that the appropriate differential is "in the neighborhood of 20 mills." At the conclusion of this rate case, the Commission will issue a final order and expect PGE to file compliance tariffs. The nature of Staff's proposals are so unclear that PGE would not know how to proceed if the Commission adopted them.

In sum, PGE supports continuation of our current and proposed practice of having the same energy prices throughout the year. The customer groups in this proceeding also support PGE's position. Staff's proposal is unwarranted and unwise. It would result in customers incurring higher bills in the third quarter and lower bills in the fourth quarter when overall energy prices are higher in the fourth quarter and lower in the third quarter. We continue to support opening a docket in 2009 to discuss marginal cost, rate design and pricing issues. In that docket, PGE, CUB, ICNU, Kroger, and Staff will be able to more fully examine Staff's proposals and alternative rate structures.

B. Low-income issues

CAPO/OECA offers no new support for its proposals. For the reasons set forth in PGE's Opening Brief and in testimony, the Commission should reject each of CAPO/OECA's specific proposals, which no other party supports.

C. The Commission should adopt PGE's decoupling proposals

The central decision before the Commission is whether to continue the current misalignment of utility customer and utility shareholder interests when it comes to energy efficiency. Oregon has a long-standing commitment, as a matter of both law and policy, to pursue all cost-effective electricity savings and avoid unnecessary expenditure on generation and grid additions. (PGE/2100, Cavanagh/5.) The Commission has an opportunity in this

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proceeding to continue its long-standing efforts to align shareholder and customer interests in reducing electricity needs.

Unfortunately, the benefits of aligning utility customer and utility shareholder interests have not been addressed by the other parties. Rather, CUB, Staff and Kroger broadly oppose decoupling because they believe the proposal will shift risks between customers and the utility in a manner not to their liking. In a nutshell, the arguments opposing decoupling are, at their core statements, that the parties like the way things are now, and fail to address the more crucial question of creating a regulatory structure that aligns interests and objectives over time.

The other parties do not deny that the current regulatory structure punishes utility shareholders for effective energy efficiency and provides those same shareholders with a windfall for every incremental kilowatt hour sale above forecast loads. Staff, CUB, and Kroger simply want the Commission to ignore this core contradiction in current regulatory policy. We believe the Commission must remove this misalignment in order to promote energy efficiency and foster a sound ratemaking approach for the recovery of fixed costs.

PGE's decoupling proposal ensures that risks and rewards are balanced. For example, the decoupling mechanism is applied to weather normalized loads, meaning the utility still retains weather related risk. In addition, changes in cost are not incorporated into the decoupling adjustment, leaving cost variation as a risk for the utility. Finally, any annual adjustment rates caused by the mechanism will not exceed two percent. This provides a "circuit breaker" assuring customers that any rate impact will be relatively small.

Staff and the other parties opposing the decoupling, focus on the fact that if customers lower consumption, they can expect to see an adjustment under the decoupling mechanism that shares some of the savings from energy efficiency with the utility. (*See, e.g.*, Staff Opening Brief at 30.) Staff and the other parties do not explain why or even if this outcome is improper. The fixed costs to be recovered through the decoupling adjustment are costs PGE

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has actually incurred to provide utility service to its customers. The parties provide no basis for believing PGE should not recover those costs.

More important, the example ignores the benefits that accrue to customers if PGE's shareholders' incentives were in line with customers' interests when it comes to energy efficiency. The current misalignment of interests will no doubt impede the effectiveness of energy efficiency programs. Aligning PGE shareholder and customer interests will foster and increase the efficacy of those programs. That is why Ralph Cavanagh, a recognized expert in the area and no champion of shareholder interests, supports PGE's decoupling proposal. By driving increased energy efficiency, decoupling will benefit customers by reducing their electricity needs over time. The example Staff and the other parties rely upon ignores this fact and assumes, without support, that energy efficiency programs will proceed unaffected by the current misalignment of interests between utility customer and utility shareholder.

Neither Staff, CUB nor Kroger challenge the basic mechanics of our SNA decoupling mechanism. The mechanism can result in refunds and lower surcharges and is not biased in either direction. The parties opposing decoupling do not dispute this. We do not deny that our decoupling proposal is a change from the status quo. We believe that change will be a benefit to our customers by modifying the Commission's existing ratemaking policies to align utility incentives with the delivery of cost-effective energy efficiency measures.

X. CONCLUSION

We respectfully request that the Commission issue a Final Order (i) approving PGE's rate request in this docket, (ii) approving the stipulations filed in this docket; (iii) approving PGE's proposed tariffs; (iv) approving a change in PGE's underground FITNES to

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a ten-year cycle; and (v) authorizing the creation of a regulatory asset for the above-average generation and plant O&M expenses identified herein and its recovery over a five-year amortization period.

DATED this 4th day of November, 2008.

PORTLAND GENERAL ELECTRIC COMPANY

FOR **Douglas C. Tingey**
121 SW Salmon Street, 1WTC1300
Portland, OR 97204
Telephone: 503-464-8926
Fax: 503-464-2200
E-Mail doug.tingey@pgn.com

TONKON TORP LLP

David F. White, OSB No. 01138
Direct Dial 503-802-2168
Direct Fax 503-972-3868
E-Mail david.white@tonkon.com
Paul W. Conable, OSB No. 97536
Direct Dial 503-802-2188
Direct Fax 503-972-3888
E-Mail paul.conable@tonkon.com
888 SW Fifth Avenue, Suite 1600
Portland, OR 97204-2099

Of Attorneys for Portland General Electric Company

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CERTIFICATE OF SERVICE

I hereby certify that on this day I served the foregoing **PORTLAND GENERAL ELECTRIC COMPANY'S REPLY BRIEF** by e-mail and/or mailing a copy thereof, to each party that has not waived paper service, in a sealed, first-class postage prepaid envelope, addressed to each party listed below and depositing in the US mail at Portland, Oregon.

Jim Abrahamson – Confidential
Community Action Directors of Oregon
PO Box 7964
Salem OR 97301
jim@cado-oregon.org

Kurt J. Boehm -- Confidential
Boehm Kurtz & Lowry
36 E Seventh St - Suite 1510
Cincinnati OH 45202
kboehm@bkllawfirm.com

Roger D. Colton -- Confidential
Fisher Sheehan & Colton
34 Warwick Rd
Belmont MA 02478
roger@fsconline.com

Joan Cote -- Confidential
President, Oregon Energy Coordinators Association
2585 State St NE
Salem OR 97301
cotej@mwvcaa.org

Jim Deason -- Confidential
Attorney at Law
1 SW Columbia St, Suite 1600
Portland OR 97258-2014
jimdeason@comcast.net

Patrick Hager -- Confidential
Portland General Electric
Rates & Regulatory Affairs
121 SW Salmon St
Mail Code: 1WTC0702
Portland OR 97204
pge.opuc.filings@pgn.com

Robert Jenks -- Confidential
Citizens' Utility Board of Oregon
610 SW Broadway, Suite 308
Portland OR 97205
bob@oregoncub.org

Judy Johnson -- Confidential
Public Utility Commission
PO Box 2148
Salem OR 97308-2148
judy.johnson@state.or.us

Jason W. Jones -- Confidential
Department of Justice
Regulated Utility & Business Section
1162 Court St NE
Salem OR 97301-4096
jason.w.jones@state.or.us

Michael L. Kurtz -- Confidential
36 E 7th St, Suite 1510
Cincinnati OH 45202-4454
mkurtz@bkllawfirm.com

G. Catriona McCracken -- Confidential
Legal Counsel
610 SW Broadway - Suite 308
Portland OR 97205
catriona@oregoncub.org

OPUC Dockets
Citizens' Utility Board of Oregon
610 SW Broadway, Suite 308
PORTLAND OR 97205
dockets@oregoncub.org

Kip Pheil -- Confidential
Oregon Department of Energy
625 Marion St NE - Suite 1
Salem OR 97301-3737
kip.pheil@state.or.us

Janet L. Prewitt -- Confidential
Department of Justice
Natural Resources Section
1162 Court St NE
Salem OR 97301-4096
janet.prewitt@doj.state.or.us

Douglas C. Tingey -- Confidential
121 SW Salmon
Mail Code: 1WTC13
Portland OR 97204
doug.tingey@pgn.com

S. Bradley Van Cleve -- Confidential
Davison Van Cleve PC
333 SW Taylor - Suite 400
Portland OR 97204
mail@dvclaw.com

Michael T. Weirich -- Confidential
Department of Justice
Regulated Utility & Business Section
1162 Court St NE
Salem OR 97301-4096
michael.weirich@doj.state.or.us

Scott Winkels -- Confidential
League Of Oregon Cities
Intergovernmental Relations Associate
PO Box 928
Salem OR 97308
swinkels@orcities.org

DATED this 4th day of November, 2008.

TONKON TORP LLP

By David White

David F. White, OSB No. 01138
Paul W. Conable, OSB No. 97536

Attorneys for Portland General Electric Company

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BEFORE THE PUBLIC UTILITY COMMISSION

OF OREGON

UE 197

In the Matters of PORTLAND GENERAL ELECTRIC COMPANY Request for a General Rate Revision	**PORTLAND GENERAL ELECTRIC COMPANY'S REPLY BRIEF**

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Tonkon Torp LLP
888 SW Fifth Avenue, Suite 1600
Portland, Oregon 97204
503-221-1440

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888 SW Fifth Avenue, Suite 1600
Portland, Oregon 97204
503-221-1440

I. INTRODUCTION

We agree with the other parties in this docket that PGE has the burden of proof. We take that responsibility seriously. We have filed over 643 pages of testimony, 133 exhibits, and responded to almost 1,000 data requests not including electronic worksheets. Our request is built from the "bottom-up," justifying each new project and worker needed to offer safe, reliable, and efficient service to our customers during the 2009 test year. We don't rely on speculation, out-dated information or over-generalizations to forecast the needs of our system and our customers. We determine what it will take to operate the system during the test year and forecast the cost associated with that operation. That is how we satisfy our burden of proof: project-by-project, worker-by-worker.

The parties opposing our request take a different tact. Notwithstanding their mantra that we have not met our burden of proof, they complain that the evidence is too detailed and supported by actual departmental budgets. They say the case is too focused on "the underbrush" (CUB Opening Brief at 11) or our "bottom up" budget process. (ICNU Opening Brief at 10.) They ask the Commission to ignore real-world conditions during the test year, inviting the Commission to engage in speculation, such as:

- assume PGE can cut 1% from its revenue requirement without any evidence that substantial cuts can be made without undermining service quality and reliability,
- assume historic information and trends will continue while ignoring direct evidence that the future will impose new requirements and obligations; and
- assume PGE has no cost control measures in place even though (i) no one can point to significant additional discretionary programs to cut and (ii) the absence of easy cuts suggests just the opposite.

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Portland, Oregon 97204
503-221-1440

We embrace the burden of proof the other parties say is placed upon us. It is a reminder of what this and other rate cases are supposed to be about. Test year service conditions that will continue into the future and the cost of such service, not wishful thinking that the future imposes no new obligations or that major cuts can be made without reducing service quality and harming the financial strength of the utility.

The remainder of this reply brief is organized as follows:

- Section II rebuts CUB's proposal to cut 1% of PGE's entire revenue requirement;
- Section III addresses workforce related adjustments in this docket (adjustment to the number of FTEs, wages and salaries, incentives and loadings);
- Section IV discusses distribution O&M and customer service issues;
- Section V focuses on plant and generation O&M matters;
- Section VI addresses compensation related issues;
- Section VII analyzes A&G expenses still in dispute;
- Section VIII reviews the remaining tax related items; and
- Section IX sets forth PGE's position with respect to pricing issues (Staff's seasonal pricing proposal, low income issues, and decoupling).

II. THE COMMISSION SHOULD REJECT CUB'S PROPOSAL TO CUT 1% OF PGE'S ENTIRE REVENUE REQUIREMENT

CUB continues to request that the Commission make a 1% reduction of PGE's entire revenue requirement. (CUB Opening Brief at 43.) This proposed reduction is not linked to anything allegedly imprudent or any unnecessary cost identified by CUB. Rather, it is based on CUB's generalized suspicion that PGE must have some imprudent costs somewhere that CUB and the other parties have simply failed to identify.

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As PGE pointed out in its Opening Brief, CUB is essentially asking the Commission to first examine test period costs to determine fair, just and reasonable rates, and then make a further downward adjustment unconnected to any specific finding about any specific cost. This is inconsistent with the general policy that the Commission must allow a utility the opportunity to recover prudently incurred operating expenses. (*See* UE 115, Order No. 01-988 at 5 (Nov. 20, 2001).)

In its Opening Brief, CUB argues that PGE is misstating CUB's argument by focusing on O&M costs. CUB argues that it simply wants PGE to take a 1% deduction on its entire revenue requirement, but that as far as CUB is concerned, PGE can take those cuts anywhere.

CUB misses the point of PGE's argument. CUB's specific allegations of imprudent expenses relate almost exclusively to O&M costs. This is because the great majority of PGE's revenue requirement, comprised of power costs, cost of capital, depreciation and amortization, and taxes and fees (except property taxes) has either been settled or is undisputed. O&M expenses account for only a small portion of this request and only about 20% of PGE's total revenue requirement. (PGE/2200, Piro/6.) CUB has identified some allegedly imprudent expenses – which even CUB acknowledges are "not large," (CUB Opening Brief at 39) – and from those specific examples argues for a 1% reduction across PGE's entire revenue requirement, including the 80% that is not in dispute here. Viewed in relation to the disputed items, this proposed reduction is of much greater magnitude than CUB suggests.

The larger problem with CUB's argument is that it depends entirely on a logical fallacy. CUB alleges that it has found a handful of imprudent expenses which it concedes are "not large." From this, CUB asks the Commission to infer that there must be other, large items of imprudent expense that CUB has simply failed to uncover. CUB's failure to find large items

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Portland, Oregon 97204
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of imprudent expense cannot be taken as evidence that such large items exist. It is the opposite of evidence for that proposition.[1]

CUB seeks to make up for the lack of evidence by referring in general terms to the increase in PGE's total revenue requirement. (*See*, e.g., CUB Opening Brief at 9.) What CUB fails to acknowledge, however, is that almost two-thirds of this entire increase is related to increased power costs and 80% is undisputed. Accordingly, the increase should not be seen as evidence of some sort of persuasive lack of cost control in PGE's O&M costs.

CUB tries to link its claims of "not large" imprudent O&M expenses with its general statements about increases in PGE's revenue requirement. From this, CUB apparently hopes that the Commission will infer that these revenue-requirement increases are somehow related to the minor expense items that it has identified. But it would be improper and illogical to draw this connection. The vast majority of the increase in PGE's total revenue requirement is already explained on this record by corresponding increases in power costs. It should not be taken as evidence of mysterious imprudent O&M expenses that CUB has yet to discover.

In the same vein, CUB asks the Commission not to focus on the "underbrush," but rather on the "big picture." (CUB Opening Brief at 10-11.) By "underbrush," CUB apparently means the actual items of expense from PGE's budget that it has identified. By "the big picture," CUB apparently means unsupported arguments about PGE's internal cost controls. The problem is that "underbrush" is all that CUB has presented to the Commission; these minor items of allegedly imprudent expense are the totality of CUB's substantive case.

It is not unreasonable to expect CUB to come forward with evidence of the pervasive excesses it alleges. The Commission should proceed based on the actual content of

[1] In fact, Staff conducted a detailed review of PGE's actual transactions from 2007 and found only small amounts as part of their miscellaneous A&G and O&M adjustments (S-9) that they specifically characterize as "discretionary." (*See* Staff/300, Ball-Daugherty/14-15, 21.) In addition, CUB complains that PGE was able to identify only one discretionary capital job in its 2009 capital budget. (*See* CUB/200, Jenks/31 and CUB Opening Brief at 45.) Yet, CUB cannot identify any other discretionary or imprudent projects from the lengthy list of PGE capital jobs provided as CUB Exhibit 216.

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Portland, Oregon 97204
503-221-1440

the record, rather than on CUB's rhetoric and leaps of logic. CUB is asking the Commission to disallow unspecified items of expense without any evidence or argument that those items are imprudent.

III. WORKFORCE – RELATED ADJUSTMENTS SHOULD BE REJECTED

A. The other parties' exclusive reliance on historic data is inconsistent with Commission policy and should be rejected.

We agree with ICNU's statement that the central issue in this case concerns whether wages and other employee related costs should be based upon (i) PGE's estimate of the activities and programs needed to provide safe and reliable service during the test year 2009 or (ii) historic information alone. (ICNU Opening Brief at 9.) PGE's testimony described its budgeting process, the primary drivers for the increase in FTEs for the test year 2009, and the basis for each incremental FTE. (*See, e.g.*, PGE/1400, Tooman-Tinker/7-10.) The other parties have not disputed this evidence. Instead, they rely on the principle that the test year must be based on actual historic information and historic trends only. (ICNU Opening Brief at 9-10.) They ask the Commission to ignore actual company budgets used to forecast test year conditions. (*Id.*)

The other parties' position cannot be squared with the Commission's practice and policies. Staff's preference for actual historic data alone is simply not supported by Commission orders. Indeed, the Commission expressly uses "future test years" which may be derived from historic or forecasted data:

> A test year is a forward-looking representation of the first year when rates will be in effect. It should present prospective recurring costs and revenue relationships that will fairly represent the period when rates from the docket will be in effect. It should comply with Commission orders and policies, as well as state and federal laws. It should contain relationships that will not substantially change as customers or access lines increase or decrease. It can be based on **historic**, **future**, or **forecast data**. [emphasis supplied.]

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Portland, Oregon 97204
503-221-1440

In re United Telephone Company of the Northwest dba Sprint. (UT 155, Order No. 03-382, Appendix A at 7 (June 30, 2003).)

While the source of rate case information may be either historic or forecasted data, the purpose of the test year is to represent *expected* operations during the rate period and the costs associated with such operations. The notion that the Commission should ignore budgets in determining the costs of providing service during the test year defies common sense and established ratemaking principles. (*American Can Co. v. Lobdell*, 55 Or App 451, 454-55 (1982) ("When a future test year is used, the data is drawn from budget figures and financial models of the utility."))

In fact, ICNU and CUB ignore conditions that will apply during the test year period and focus instead on the past. This approach is strikingly similar to the position ICNU and CUB advanced in UE 115. There, ICNU sought to cap PGE's O&M expenses based on historic actual levels escalated by anticipated customer growth and inflation. (UE 115, Order No. 01-777 at 8.) As in this case, PGE developed its UE 115 forecasted revenue requirement using traditional ratemaking principles, starting with budgeted information and adjusting those figures to remove nonrecurring events. (*Id.*) The Commission expressly adopted PGE's approach while rejecting the backward-looking approach ICNU and CUB sponsored:

> We also reject CUB's and ICNU's inflation-escalator proposals as independent methods to establish non-power O&M costs for PGE. Consistent with established Oregon rate making principles, PGE's test year should be based on actual or budgeted expenditures and adjusted to remove abnormalities and to include known and measurable changes that are expected to persist. The parties' respective inflation benchmark proposals are not appropriate for evaluating PGE's expenditures, because the methodologies do not examine the reasonableness of historical operations, fail to consider abnormalities in the base line years results of operation and do not take into account known and measurable changes between the baseline and test year, such as the passage of SB 1149.

(*Id.* at 9.)

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Nor do the orders upon which ICNU relies withstand review. ICNU cites an order from UT 125 for the proposition that "as a general rule, actual data is preferable to forecasted data". (ICNU Opening Brief at 8.) In fact, that decision is diametrically opposed to ICNU's backward-looking rule. In that case, the Commission said that "the issue here is not whether actual data are preferable to forecasted data." (UT 125, Order No. 00-191 at 96 (April 14, 2000).) Instead, the Commission rejected US West's attempt to rely on actual data submitted so late in the case that it could not be verified. (*Id.*) The Commission expressly disavowed addressing the issue ICNU claims it decide and rejected actual data in favor of rate case forecasts. It's hard to imagine a case less favorable to a backward-looking approach.

Finally, ICNU's reliance on the Commission's order in a PacifiCorp rate case is ill founded. (ICNU Opening Brief at 8 citing Order No. 01-787.) The Commission decision in that case was based on a different record involving a different utility, and concerned a completely different request for wages and salaries and other related items.

ICNU seeks to distract from the real issues in dispute by suggesting that "none of the parties have had the opportunity to thoroughly review that budget to understand the underlying assumptions and calculations." (ICNU Opening Brief at 10.) ICNU and the other parties in this proceeding have had more than an adequate opportunity to thoroughly review PGE's forecast and budget. PGE has responded to approximately one thousand data requests in this docket, which has included multiple workshops, two rounds of testimony for Staff and interveners, a hearing, and now two rounds of briefs. Intervenors efforts have also been supported by intervenor funding. If this proceeding has not afforded the parties an adequate opportunity to review a utility's request, then no process possibly can.

As we stated in our opening brief, the Commission should reject the backward-looking formulaic approaches Staff, CUB, and ICNU endorse. However, to the extent actual historic results are deemed paramount and forecasts of test year conditions discounted for

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determining FTEs, the Commission should use the alternative PGE described in sursurrebuttal testimony, which used the most recent actual data available and avoided the controversy surrounding "conversion hours." (*See* PGE Opening Brief at 11-12; PGE/2300, Tooman-Tinker/15.)

B. Staff's approach uses the wrong FTE assumptions

Staff proposes a reduction of 98 FTEs from PGE's request with an associated $11.2 million cost adjustment. Staff starts from an estimate of actual 2007 FTEs, escalates that number by a growth rate, and then compares the result to PGE's initial FTE request. All of the flaws in Staff's proposed FTE adjustment are described in PGE's opening brief on pages 9-12.

In its opening brief, Staff continues to use the wrong figure for baseline year 2007. (Staff Opening Brief at 4.) The correct actual FTE figure for 2007 is 2,612, contained in PGE's 2007 Results of Operations Report. (PGE/1400, Tooman-Tinker/8.) PGE regrets that it initially provided an incorrect figure when it first provided actual 2007 FTEs. But this is no excuse for Staff's position that it will use the uncorrected figure even after PGE corrected the figure in both rebuttal and sursurrebuttal testimony. (PGE/1400, Tooman-Tinker 8; PGE/2300, Tooman-Tinker/10-11.) ICNU and CUB have accepted PGE's revised figure for 2007 actual FTEs. Indeed, Staff's growth rate for FTEs is based upon PGE's revised figure for 2007 actual FTEs. Staff and the Commission should use PGE's corrected 2007 figure consistently for both the growth rate and the 2007 baseline.

Aside from using the wrong starting point for its analysis, Staff fails to update PGE’s request to reflect PGE’s current position. As discussed in PGE’s testimony and its opening brief, PGE initially forecasted 2,733 FTEs (not including non-exempt overtime). We subsequently included a number of adjustments reducing the number of forecasted FTEs to 2,706. The principal adjustment was the elimination of 30 FTEs from PGE’s request to reflect the average level of unfilled vacancies. (PGE/1400, Tooman-Tinker/7-10.) Without any basis in

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Portland, Oregon 97204
503-221-1440

the record, Staff takes the position in briefs that PGE's initial forecast of 2,733 FTEs already included this 30 FTE reduction made during the case. (Staff Opening Brief at 5.) This is just wrong. PGE's rebuttal testimony graphically showed that PGE reduced its initial request from 2,733 to 2,706 FTEs, including the 30 FTEs for unfilled vacancies:

Table 1
Adjustments to 2009 FTEs

Original 2009 FTEs	2,733
Removed four FTEs associated with PGE's heat pump program so it is not included in rates	-4
Removed 20 distribution FTEs as unfilled positions (offsetting credit included)	-20
Removed 10 customer service representative FTEs as unfilled positions (offsetting credit included)	-10
Added seven FTEs to meet additional FERC/NERC/WECC compliance requirements	+7
Adjusted 2009 FTEs	2,706

(PGE/1400, Tooman-Tinker/10.)

Staff and the other intervenors attempt to create a diversion by claiming confusion regarding the different FTE figures used in this case. (Staff Opening Brief at 3-4; ICNU Opening Brief at 11.) This is a smokescreen, not a legitimate complaint. In rebuttal and sursurrebutal testimony, PGE explained the different FTE figures used in this case and how each was derived. (*See, e.g.*, PGE/1400, Tooman-Tinker/6-10; PGE/2300, Tooman-Tinker/8-13.) PGE has consistently used the same numbers for FTE in its rebuttal and sursurrebuttal testimony. (*Id.*) ICNU's claim that PGE has been inconsistent with respect to FTEs is simply wrong. (ICNU Opening Brief at 11.) The differences ICNU identifies reflect nothing more than FTEs with and without paid overtime. The difference between these FTE totals was clearly identified in all instances and FTEs representing paid overtime were not contested by the other parties (except ICNU in Opening Briefs – s*ee* below). This reflects legitimate differences based upon different standards, not inconsistency or misrepresentation, as ICNU suggests.

As we discussed in our opening brief, proper implementation of Staff's approach would yield an adjustment of 18 FTEs. We do not support Staff's approach. However, if done

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888 SW Fifth Avenue, Suite 1600
Portland, Oregon 97204
503-221-1440

correctly, Staff's approach should result in a $2 million reduction to PGE's labor costs, not Staff's proposed $11.2 million cost reduction. (PGE/1400, Tooman-Tinker/10, PGE Opening Brief at 9-11.)

C. ICNU-CUB's workforce, wages and salary, and payroll-related adjustments are unpersuasive and should be rejected

ICNU seeks to interject into this proceeding a number of new factual claims and adjustments that are unsupported in the record and that seek to supplement the record. For example, ICNU proposes new adjustments for payroll expense, benefits and incentives, and overtime that substantially diverge from its witness' testimony in this proceeding. (*See* ICNU Opening Brief at 9 and Exhibit 1 to ICNU Opening Brief.) Moreover, ICNU refers to anecdotal evidence regarding current economic conditions that was never introduced into the record in this proceeding, much less subject to review, discovery and rebuttal. (*See* ICNU Opening Brief at 17.) ICNU fails to seek permission to file such material after the record has been closed. Accordingly, the Commission should reject ICNU's revised request with respect to these matters given that it relies on factual claims outside the record. The Commission should limit its decision to ICNU's testimony and exhibits provided during this proceeding, which are part of the record. The final order should not rely upon new factual claims contained in briefs that have not been subject to discovery or rebuttal testimony or evidence.

1. <u>ICNU–CUB's adjustment to the number of FTEs should be rejected</u>

ICNU claims confusion regarding how FTEs are calculated. (ICNU Opening Brief at 13.) PGE has been clear on how FTEs are calculated for rate making purposes all along. An FTE represents approximately 2,080 hours of work.[2]

[2] For more detail on FTE calculations, *see* PGE Exhibit 2300, page 10. FTEs do not reflect employees or head count because FTEs represent hours over time and employees represent people at a point in time. Instead, FTEs reflect the level of effort needed to perform PGE's regulated activities. (PGE/1400, Tooman-Tinker/6.)

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We are puzzled by ICNU's statement that "exempt overtime hours should not be converted to FTEs." (ICNU Opening Brief at 12.) "Exempt employees" are employees who are exempt from payment of overtime under the Fair Labor Standards Act. PGE's Opening Brief and testimony addressed why it is appropriate to convert those hours over 2,080 for exempt employees (or "conversion hours," as we call them), when calculating the total number of FTEs for rate making purposes. (*See* PGE Opening Brief at 10-11; PGE/2300, Tooman-Tinker/10-12.) ICNU has no basis upon which to complain about PGE's use of conversion hours – i.e., using exempt overtime hours to calculate test year FTEs. Ms. Blumenthal uses the figure of 2,612 FTEs for the 2007 baseline figure, an amount that is based on conversion hours. (*See* ICNU-CUB/111, Blumenthal/7.)

ICNU's complaint regarding PGE's over budgeting for FTEs is similarly ill-founded. (ICNU Opening Brief at 12-13.) In advance of parties raising the issue that PGE historically has a certain number of unfilled positions, PGE removed 30 FTEs to reflect the historic average of such unfilled positions. (PGE/1400, Tooman-Tinker/14-15.) Accordingly, ICNU's concern has already been addressed.

ICNU's position on the number of FTEs continues to lack evidentiary support. As pointed out in PGE's opening brief, Ms. Blumenthal used a "plug" escalation rate of one percent to forecast test year FTEs. Ms. Blumenthal offers no explanation or support for this escalation rate. It bears no relationship to the historic growth rates in the tables accompanying Ms. Blumenthal's testimony. ICNU's Opening Brief graphically demonstrates this fatal flaw. For base 2007 actual FTEs, ICNU acknowledges that this figure should be 2,612. (ICNU Opening Brief at 14.) However, it calculates the escalation rate to apply to this figure using a different basis than its reply testimony and one that was unexplained and unverifiable in its surrebuttal testimony. ICNU's unsupported theory should be rejected.

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ICNU's proposal also contains several errors. For example, ICNU overstates the adjustment by double counting officer wages. PGE's test year request of 2,706 FTEs includes officers. (*See* Hearing Transcript at 53.) Yet, ICNU inflates its adjustment amount by adding officer wages again when it states the amount of PGE's request. (Exhibit 1 to ICNU's Opening Brief between lines 3 and 4.) ICNU is also wrong when it states that PGE is requesting $221,372,069 in wages and salaries. (ICNU Opening Brief at 16 (citing ICNU Exhibit 119 at 2).) At the hearing, Mr. Tooman testified that ICNU Exhibit 119 did not reflect the revenue requirement in the case because it double counted officer wages. (Hearing Transcript at 56.)

2. <u>ICNU's wage adjustment arbitrarily ignores historical data and relies instead on unverified anecdotal information</u>

PGE's pay structure is determined by the relevant markets in which PGE competes for labor. PGE routinely compares its wages and salaries to what comparable companies pay to ensure that PGE offers competitive market wages and salaries. (PGE/800, Barnett-Bell/6.) As pointed out in our Opening Brief, Ms. Blumenthal uses an arbitrary method to forecast increases in PGE's wages and salaries. She selectively removes certain data from her analysis when it contradicts or does not support the predetermined outcome. (PGE Opening Brief at 14-15.)

ICNU's position that officer compensation is "out of control" is simply unfounded. In 2006, PGE hired an outside, independent third-party expert, Watson Wyatt, to conduct a market analysis. (Hearing Transcript at 22.) This third party expert reviewed surveys, such as the *Towers Perrin Executive Survey*, as well as 14 similar companies and other market data. (*Id.*) This analysis showed that PGE officers were compensated *well below market*. As a result, officer compensation was increased to bring them to just below, not above, market:

> Basically they determined what the ranges of salaries should be, the mid points, and our executives were brought from well below the market to almost market. For example, Peggy Fowler went from the 25th percentile to the 39th. (Hearing Transcript at 23.)

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ICNU relies on anecdotal material (ICNU Exhibits 124, 125 and 126) regarding other local utilities that is thoroughly unpersuasive. (ICNU Opening Brief at 22.) First, there is no testimony or record evidence supporting or explaining this material. There is no testimony or evidence describing how the compensation information was compiled. ICNU introduced this raw data at the hearing affording no opportunity to review, verify, or rebut such material. ICNU submitted two rounds of written testimony and their expert never offered, supported, or mentioned this information. The PGE witness to whom ICNU showed the exhibits had no personal knowledge of the material. Hearing Trans. at 27-30.

Second, the material ICNU relies on includes information regarding PacifiCorp, which is no longer part of PGE's comparative group after its acquisition by Mid American. (Hearing Transcript at 29.) Third, the list of officers included in the material ICNU cites is not comparable to the PGE officers in this rate case. Fourth, PGE draws its executives from national markets, not just the local market, which is the exclusive source of ICNU's exhibit. (Hearing Transcript at 29.) Finally, ICNU has failed to produce an objective, systematic market study. Instead, it has pulled off-the-shelf anecdotal information that does not compare to the systematic, objective and market oriented evidence in this docket that shows that PGE's officer compensation is below market and supports PGE's 2009 forecast.

3. <u>ICNU's overtime adjustment is without any support in the record</u>

ICNU proposes for the first time, an adjustment to PGE's overtime wages request. (ICNU Opening Brief at 17.) ICNU's theory, unsupported with any references to testimony for the record, is that overtime should be reduced as the number of FTEs is reduced. There is no basis for ICNU's assumption in the record or in logic. Indeed, the opposite inference is more likely. With fewer employees to do to the work, overtime hours may in fact increase. In any event, PGE determines the amount of overtime wages in its request based upon budgets from individual departments. (*See* PGE/1300, Piro/29.) This amount is included in the rate case

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request, and no party has previously objected to this component of PGE's request. Overtime requirements are driven by any number of factors, including outages and storms, which do not conveniently occur during normal weekday working hours. Accordingly, ICNU's adjustment should be rejected.

4. <u>ICNU's method of adjusting the payroll loadings rate overstates adjustment amounts</u>

ICNU continues to be confused about the use and application of payroll loadings. As we discussed in our Opening Brief, the payroll-related costs that these loadings represent (payroll taxes, employee benefits, incentives and employee support) are not included in this case through application of the loadings rate. Instead, each amount is directly forecasted. The loadings rates are then a derivative of these costs and not vice versa. (PGE Opening Brief at 12, 18-19.) Accordingly, adjustments for payroll-related costs should be made directly and not through a loadings rate adjustment, as ICNU does. (ICNU Opening Brief, Attachment 1.)

ICNU's approach of removing such costs through a loadings rate adjustment significantly overstates the adjustment amount even after their attempted corrections in Exhibit 1 of ICNU Opening Briefs. This is because ICNU continues to assume incorrectly (i) that the loadings rate drives the revenue requirement request and (ii) that payroll-related costs change as a direct function of payroll.[3]

To give just one example, PGE's benefits expenses are forecasted directly in its request. ICNU, on the other hand, forecasts benefits based on the application of a loadings rate to labor costs. (*See* ICNU Opening Brief, Attachment 1.) Therefore, any reduction in labor costs reduces benefits costs under ICNU's model. In fact, most benefit expenses do not vary based on total labor costs. The majority of ICNU's payroll adjustment is based on its claim that wages should be reduced. (*See* ICNU Opening Brief, Attachment 1.) This reduction in wages will have

[3] PGE's allocation methodology is clearly defined, has been audited by the OPUC Staff, has been authorized in numerous rate cases, and is provided annually as part of PGE's Affiliated Interest filing. (PGE/1400, Tooman-Tinker/17-18.)

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no effect whatsoever on medical benefits costs, which are based on the number of employees and the selections they are expected to make for insurance coverage (e.g., employee only, employee with spouse, employee with family). ICNU is simply wrong on the whole notion of loadings and how to use them.

5. ICNU's Employee Support Adjustment Is Unjustified

ICNU claims it has no objection to including employee support at the level included in UE-180 rates. (ICNU Opening Brief at 19.) Yet, ICNU makes an adjustment by removing employee support from the loadings rate without adding back these costs anywhere else. This generates a $5.7 million reduction in PGE's revenue requirement request with no means for PGE to recover these costs, notwithstanding ICNU's position that it would support employee support at UE-180 levels.

As we mentioned in our Opening Brief, ICNU's only objection to employee support -- that employee support costs do not vary with payroll and therefore should be removed from the loadings rate -- misses the point. (PGE Opening Brief at 14.) PGE directly forecasts employee support costs in its rate case. PGE then allocates the support costs across various activities but it does not use the loadings rate to derive or support its revenue requirement request.

ICNU's argument that PGE has counted employee support costs twice again derives from its misunderstanding of how we use payroll loadings. (ICNU Opening Brief at 19.) Employee support costs are forecasted directly under A&G. (PGE/500, Piro-Tooman/2.) That is the only place such costs are included in PGE's request. PGE does not use the loadings rate to generate yet another figure for employee support costs as ICNU suggests.

It does not matter that employee support is labor intensive and therefore included in the total number of FTEs, as ICNU suggests. (ICNU Opening Brief at 19.) These costs are forecasted and included directly in the revenue requirement. They are then divided by the

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appropriate labor base to derive a payroll loading rate, which is used to allocate some of those costs to capital. (PGE/2300, Tooman-Tinker/19.) That allocation does not in any way lead to double counting of such costs. In fact, it removes costs from A&G and allocates them to capital projects and "below the line."

D. The other parties' arbitrary disallowance of 50% of PGE's non-officer incentives should be rejected

None of the parties in this proceeding dispute that PGE's non-officer incentive programs align compensation with customer benefits. Indeed, because the incentive plans are aligned "toward customer benefit" Staff increases the amount it would otherwise support. (Staff Opening Brief at 7.) However, Staff's and other intervenors' reliance on Commission Orders Nos. 99-697 and 99-333 as a starting point is misplaced. The Commission's prior policy as articulated in those orders was targeted specifically at benefit plans that "are generally focused on the company's increased earnings and, therefore, bring more benefits to shareholders." (Order No. 99-697 at 44.)

PGE's incentive plans are neither focused on shareholder benefits nor divorced from our customers' interests. Rather, the incentive plans are designed specifically to ensure that incentive payments dovetail with customer benefits. As such, PGE's incentive plans in this case bear no resemblance to the officer compensation plans that were the subject of the Commission's policy in the 1980s and 1990s. More recent Commission orders offer more support for a change in policy. In UE 115 (Order No. 01-777), the Commission allowed 85% of PGE's non-officer incentives. (PGE Ex. 2402.) In UE 180 (Order No. 07-015), the Commission allowed 75% of PGE's non-officer incentives. (PGE Ex. 2403.)[4]

The other parties' response to this recent trend is to argue that we can't cite those orders. They claim that PGE agreed not to use the stipulations in those cases "as precedent in future cases." (ICNU Opening Brief at 20.) We rely not on the stipulations themselves but

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[4] If 75% of non-officer incentives were allowed, this would result in a revenue requirement adjustment of approximately $2.1 million. (PGE/2400, Barnett-Bell/10.)

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rather on the Commission's decision adopting rates that included 85% and 75% of the non-officer incentive plans in those cases. The terms of the stipulations in UE 115 and UE 180 left the parties free to cite the final order in those dockets. Moreover, the Commission has used final orders adopting stipulations as guiding precedent (as have the parties that complain about the practice in this docket). To name just one example, the Commission's policies with respect to power cost deferrals and power cost adjustment mechanisms over the last several years were founded upon the Commission orders adopting stipulations during the 2000-2001 power crisis in dockets UM 1008-1009. (UM 1071, Order No. 04-108 at 9 (March 2, 2004); UE 165, Order No. 05-1261 at 9 (Dec. 12, 2005).) Parties in those power cost proceedings liberally cited the Commission's final order in UM 1008-1009 even though the stipulations contained the exact same prohibition against citing the stipulation as precedent in future cases. We seek nothing more in relying on the final orders in UE 115 and UE 180. The Commission should follow its more recent precedent, not the outdated policy upon which Staff and other parties rest their case, and approve the inclusion of non-officer incentive plans as a reasonable component of PGE's compensation costs.

In addition to its proposed 50% disallowance of non-officer cash incentive plans, Staff now seeks to disallow 100% of the Stock Incentive Program (SIP) for non-officers. (Staff Opening Brief at 7.) PGE voluntarily removed the cost of the SIP for officers; however, no party submitted testimony or opposing the program for non-officers. Staff now claims its testimony was in error and that, contrary to its testimony, it meant to remove not just the officer SIP but the SIP in its entirety. *Id.* Whatever Staff intended in testimony, it is left with the record it created. That record provides absolutely no testimony supporting removal of the entire SIP. PGE has the right to conduct discovery, file rebuttal testimony, and conduct cross examination of witnesses on testimony. Parties have the opportunity to file errata to testimony while the record is open. Permitting a party to change its testimony after the record is closed deprives us of those rights

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and our right to a decision on the factual record, not a record the parties meant to create and now seek to amend in briefing.

Moreover, the SIP is an important component of PGE's compensation plan and provides customer benefit by promoting retention of employees (*See* PGE/800, Barnett-Bell/10-11; PGE/1500, Barnett-Bell/12.) Staff and ICNU's proposed adjustment to remove the SIP for non-officers ($1.1 million) should be rejected.

IV. DISTRIBUTION O&M AND CUSTOMER SERVICE

A. The Commission should reject Staff's proposal to reduce PGE's tree-trimming costs

Staff continues to recommend that the Commission reduce PGE's tree-trimming costs by approximately $1.3 million. This recommendation is based entirely on a misunderstanding caused by PGE's initial, erroneous response to OPUC Data Request No. 428. In that initial response, PGE mistakenly stated that it would trim approximately 4,500 line miles in 2008 and 2009. PGE has since corrected that response to reflect the accurate estimate of 4,112 miles. (PGE/2500, Hawke/6-7; PGE Ex. 2501). As explained in PGE's sursurrebuttal testimony, this correction does not reflect any change in PGE's tree-trimming plans; in other words, PGE is not planning to reduce its tree-trimming by 388 miles. Rather, PGE is correcting a double-counting error in its original response. (*Id.*)

PGE based its original $12.3 million request on the estimated amount of equipment and number of crews needed to meet PGE's tree-trimming responsibilities in 2008 and 2009. These include both the 4,112 miles of scheduled trimming that PGE has projected and other vegetation maintenance services not included in that schedule. (PGE/1600, Hawke/7-8).

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PGE's $12.3 million request was not based on the erroneous 4,500 mile estimate given in response to OPUC Data Request No. 428. Rather, it was based on PGE's actual trimming schedule and other projected vegetation maintenance. But that erroneous estimate is the sole basis for Staff's proposed reduction. Staff's recommendation is that, since PGE's estimated line-miles have "decreased" by 388, there should be a corresponding decrease in PGE's tree-trimming budget. But the budget was not based on the erroneous estimate; in fact, there has been no "reduction" in the schedule that was the basis for PGE's budget request. The only basis for Staff's proposed reduction was an error, since corrected, in PGE's sursurrebuttal testimony.

The proposed cut would not, as Staff suggests, reduce PGE's proposed tree-trimming budget to the appropriate level. Instead, it would reduce it below the level necessary to perform scheduled tree-trimming and other services. (PGE/2500, Hawke/6-7.) PGE regrets that its initial response to OPUC Data Request No. 428 was incorrect, but that response has been corrected and should not be the basis for an unjustified reduction in the budget for a necessary and mandated service.

B. PGE proposes to reduce underground fitnes costs by $900,000 based on a change from a four-year cycle to a ten-year cycle

Staff opposes PGE's plan to move Underground FITNES costs from a four-year to a ten-year cycle, even though this adjustment would result in a greater reduction of PGE's revenue requirement in this rate case. Staff does not appear to dispute PGE's point that a ten-year cycle is standard for other electric utilities in Oregon. (PGE/2500, Hawke/8.) There is no testimony opposing this change, and Staff's briefing offers no principled reason to distinguish PGE from Oregon's other electric utilities in this respect. The Commission should approve PGE's request to change to a ten-year cycle for Underground FITNES, together with the resulting reduction in PGE's costs for the program.

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C. The Commission should reject Staff's proposed reduction to the porcelain insulator replacement project

As with Staff's proposed reduction of locating costs, Staff's proposed $288,000 adjustment to PGE's porcelain insulator replacement project would leave PGE unable to adequately staff the project. Staff's proposed adjustment, for contract labor costs, fails to take into account that PGE expects to fully utilize its labor work force in addition to taking on these additional contract labor costs. Accordingly, the proposed savings that Staff envisions will not be realized. Accepting Staff's proposal to reduce contract employees on the porcelain insulator replacement project will leave PGE understaffed to complete this important project. (PGE/2500, Hawke/3.)

The flaw in Staff's argument stems from Staff's insistence on looking only at non-labor costs of this project. The 2007 actual expenses of the project reflect work by both PGE employees and contract labor. Staff disregards employee costs in comparing actual 2007 and projected 2009 costs, with the result that it escalates only a portion of PGE's work costs for the project, those related to contract labor. There is no basis for Staff's decision to ignore the expense of those employees in its 2009 calculations. The result of this error is a significant understatement of PGE's real projected costs for the porcelain insulator replacement project in 2009. This erroneous reduction would compromise PGE's ability to stay current on this project, and the Commission should not adopt it.

D. The Commission should reject Staff's proposal to deduct locating costs

In its Opening Brief, OPUC Staff repeats its argument for deducting approximately $271,000 from locating costs for the 2009 test year. Staff acknowledges that it bases its recommendation on PGE's response to Data Request No. 183, and further acknowledges that that Data Request asks for non-labor costs only. (PGE/2500, Hawke/4.)

As with the porcelain insulator replacement project, Staff's failure to account for labor costs causes a serious misstatement of PGE's real locating costs. Here, again, PGE uses a combination of employees and contract labor for locating services. Indeed, some locating services can only be performed by qualified employees. (PGE/2500, Hawke/4.) When all costs of locating are considered, Staff's proposed adjustment is significantly too high. Staff also fails to address PGE's projected increase in locating expenses. (PGE/2500, Hawke/5-6). Staff's failure to address labor costs and projected increases results in a proposed adjustment that would leave PGE with a significant cost shortfall for locating expenses. The Commission should not support this result.

E. The Commission should reject CUB's proposal to remove costs of the customer focus initiative

CUB asks the Commission to disallow the entire $300,000 cost of the Customer Focus Initiative. The Customer Focus Initiative is a modest program designed to enhance PGE's customer service. The purpose of this initiative is to serve customers better and to enhance reliability across PGE's operations. Responsiveness to customers and improving efficiency are reasonable and prudent goals for a public utility. This initiative furthers those goals for a modest cost. The $300,000 expense of this customer-focused program is reasonable and prudent, and the Commission should reject CUB's effort to strip it from PGE's request.

As with Generation Excellence (discussed below), CUB's attack on the Customer Focus Initiative demonstrates its short-sighted view of PGE's operations. These programs are designed to help customers by improving customer service and operations at PGE's generation facilities, thereby reducing outages and increasing efficiency, reliability and safety. That CUB has chosen to focus on these programs, which even CUB admits are not large components of PGE's revenue requirement, indicates that CUB places minor short-term savings ahead of long-term quality and customer service. This is not PGE's approach, and it should not be the Commission's approach either. Safety, reliability, and customer service are not trivial aspects of PGE's operations. The modest cost of these initiatives is more than justified by their long-term benefits to customers.

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V. PLANT AND GENERATION O&M

A. The Commission should reject CUB's proposal to remove all generation excellence costs

CUB asks the Commission to disallow all costs related to Generation Excellence. (CUB Opening Br. at 26.) Generation Excellence is a program focused on the continued training of skilled personnel of PGE's generation facilities. This effort is crucial and will benefit customers through decreased outages and improved service. (PGE/2600, Quennoz/4.) The benefits of properly trained personnel at generation facilities are obvious and central to PGE's mission, notwithstanding the fact that no formal cost-benefit analysis of this particular initiative has been performed. CUB's argument to the contrary is unpersuasive.

CUB also argues that it is irrelevant that Generation Excellence costs will largely be non-incremental in 2009. (CUB Opening Brief at 29.) But it is clearly relevant that PGE took on a significant portion of the Generation Excellence expense prior to the test year for this rate case, even though that expense would be unrecoverable. CUB claims elsewhere in its brief that PGE is indifferent to cost savings because PGE generally only incurs costs it can recover from customers. But PGE has shown its commitment to this initiative by incurring significant Generation Excellence expenses in 2008, despite the fact that those expenses are unrecoverable. The incremental costs of Generation Excellence in 2009 are justified by the obvious benefit of having highly trained, highly qualified staff at PGE's generation facilities. (PGE/1800, Quennoz/2-6).

B. The Commission should reject CUB's proposed removal of costs for Revision II of the Boardman Simulator

The Commission should also reject CUB's proposal to deny costs for the Boardman simulator. As with Generation Excellence, the simulator is a training component necessary to maintain and improve the quality of operations at PGE's generation facilities. (PGE/2600, Quennoz/6.)

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CUB continues to fault PGE for not conducting a separate cost-benefit analysis to accompany each increase in cost of the Boardman simulator. Although PGE has conducted one cost-benefit analysis of the simulator, the primary justification for the simulator has always been reliability, not cost savings. (*Id.*) This is a training tool, designed to improve safety and reduce outages in PGE's increasingly complex generation facilities, thereby lowering power costs over the long term. Although there are undoubtedly will be short-term economic benefits from improved training, in the form of decreased costs for off-site training and decreased cost of outages, these are not the primary justifications for the simulator. Since the simulator was first proposed, its primary justification has been reliability, which lowers power costs in the long term, and it is inappropriate for the Commission to decrease PGE's request for the simulator based on CUB's arguments about cost-benefit analyses.

C. The Commission should approve PGE's proposed creation of a regulatory asset for O&M costs for Beaver, Boardman and Colstrip plants

None of the parties dispute that PGE will incur substantial O&M costs for its Beaver, Boardman, and Colstrip generating plants in the test year 2009. (PGE/2200, Piro/10.) The only question is whether PGE will be allowed to recover those costs. By permitting PGE to recover only the nominal value of its prudently incurred costs over a ten-year period, Staff would affectively disallow a substantial portion of these costs without any claim that the costs are imprudent or unnecessary.

Staff's opening brief makes no new arguments for effectively disallowing a substantial portion of PGE's costs. It alludes to "administrative issues" associated with PGE's proposal without explaining what "administrative issues" could possibly apply to the routine creation of a regulatory asset. (Staff Opening Brief at 17.)

The Commission should adopt PGE's proposed treatment for O&M costs associated with Beaver, Boardman and Colstrip generating plants. That proposal strikes an appropriate balance between the desires to mitigate rate increases with the recognition that PGE

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should recover its prudently incurred costs. Staff's proposal is inadequate in that it fails to consider the time value of money and insures that PGE will not recover its true costs. While PGE recommends a five-year regulatory asset structure, it is willing to support a 10-year regulatory structure so long as it is permitted to recover the time value of costs incurred in the test year.

VI. COMPENSATION RELATED ISSUES

A. The Commission should reject Staff's proposed reduction to medical and dental benefits

Staff proposes removing $660,585 from PGE's request for medical and dental benefits. As discussed in PGE's surrebuttal testimony (PGE/2400, Barnett-Bell/12), Staff's proposed escalation rate of 8.5% for premiums is too low. Active union medical and dental costs are a negotiated benefit and are managed by a Taft-Hartley trust. PGE anticipates that these costs will increase at a rate similar to the increase for non-union medical and dental benefit costs, or approximately 10% annually. (PGE/1500, Barnett-Bell/15-16.)

Staff also incorrectly concludes that escalation of 2009 test year medical and dental benefits should only be applied to 10 months of the year, rather than 12 months. But, as PGE explained in our response to OPUC Data Request 419, PGE Exhibit 2404, PGE's union agreement requires it to make contributions above and beyond the fixed annual contribution if the "trust determines that there are not sufficient funds to ensure the viability of benefits for active employees covered by the collective bargaining agreement." Irrespective of the timing of a new collective bargaining agreement, medical and dental costs for active union employees are expected to rise 10% annually from the 2007 actual expense. The 10% projected 2009 increase will take effect at the beginning of 2009, not two months later. Regardless of the date of PGE's new union agreement, PGE will be responsible under its existing agreement to make increased contributions for 12, not 10, months of 2009.

When those misunderstandings in Staff testimony are corrected, the justification for Staff's proposed adjustment disappears. A table setting out the appropriate adjustments and full requirement is set out at PGE/2400, Barnett-Bell/13. No reduction is appropriate, and PGE should be granted the full amount of this request.

B. The Commission should approve PGE's request with respect to other benefits

In its opening brief, Staff claims that PGE has been unable to identify the sources for its requests for miscellaneous or other benefits. (Staff Opening Brief at 10.) Staff's argument that PGE "has continually shifted its explanation from one cost driver to another" finds no support in the record. PGE has provided ample justification for these other benefits both in rebuttal and in sursurrebuttal testimony. The drivers for the increased funding PGE is requesting have remained constant throughout its testimony. (*See e.g.*, PGE/800, Barnett-Bell/12-17, PGE/1500, Barnett-Bell/20-24, PGE/2400, Barnett-Bell/14-16; PGE Opening Brief at 29-30.) Staff's proposed adjustment in this area should be rejected.

C. The Commission should reject the proposed adjustment for PGE's long-standing employee discount

We support continuation of the employee discount for our current and future employees. This benefit is part of PGE's total compensation package that helps it to compete for qualified workers in a labor market where its direct competitors (PacifiCorp and Northwest Natural) offer a similar discount. (PGE/2400, Barnett-Bell/18.) The impact of the employee discount is less than $0.9 million in 2009. (PGE/1500, Barnett-Bell/27.)

The parties opposing this program (CUB, ICNU, and CAPO) offer no new support for the elimination of this long-standing program, which many other utilities in Oregon offer. CUB mistakenly claims that we recognize that there are "issues" with the program. (CUB Opening Brief at 21, 53.) We do not. PGE described a phase out alternative approach, not because there are "issues" with the program, but because this alternative would be less harmful

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than the complete elimination of the discount. (PGE/2400, Barnett-Bell/8.) A phase-out would not undermine the bargain made with our retired and current employees and it would do less harm to PGE's ability to retain current employees than would its complete elimination.

VII. A&G

A. The Commission should modify Staff's proposed reduction related to insurance premiums

Staff recommends removing approximately $1.83 million from PGE's projected 2009 insurance premium costs. This reduction is excessive and unsupported in the record.

D & O Insurance: PGE has demonstrated in detail why D&O insurance is a necessary, prudent and ordinary cost of the electric utility business. (PGE/1900, Piro-Tooman 16.) Adequate D&O insurance is a necessary cost of doing business and hiring competent executives and directors, and should be treated as such.

Staff argues that D&O insurance costs should be reduced by 50% because (1) shareholders, rather than customers, vote on slates of offices and directors; and (2) shareholders sometimes file lawsuits against officers and directors. (Staff Opening Brief at 14.) While true, neither of these observations demonstrates that D&O insurance is not a reasonable, ordinary and prudent cost of the public utility business. In fact, these two factual statements apply to most, if not all, investor-owned utilities. Staff does not explain why these facts about directors and officers provide evidentiary support for a 50% reduction in insurance costs. Because these costs are prudent and are an ordinary cost of doing business, they should be allowed in full.

Additional Insurance Policies: Staff incorrectly states that PGE is attempting to "bring in new insurance policies" in its sursurrebuttal testimony. (Staff Opening Brief at 14, citing PGE/2700, Piro-Tooman/4.) In making this argument, Staff simply ignores PGE's Third Supplemental Response to OPUC Data Request No. 66. (*See* PGE Exhibit 2701, 2702C, 2703C.) PGE did not attempt to introduce evidence of these policies in sursurrebuttal, and, in fact these policies were in PGE's initial filing.

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Escalations of Property Insurance Policies: PGE proposed an escalation rate of 9.4% to account for increases in property insurance policy premiums that will occur in 2009. (PGE/2700, Piro-Tooman/8, PGE Exhibit 2074C.) Staff argues that no escalation is appropriate because insurance rates are not expected to increase. (Staff Opening Brief at 15.) But PGE's proposed escalation is not based on any anticipated increase in rates. As PGE pointed out in testimony and in its Opening Brief, the basis for this escalation is the increase in value of the underlying property to be insured. Flat insurance rates can still produce increased insurance premiums when the value of the property being insured increases. That is the case here, and PGE's proposed escalation is therefore appropriate.

Allocation of Insurance Premiums between Utility and Non-Utility Property: Staff proposes to reduce the total amount of PGE's insurance costs downward by 1.79% as an adjustment for premium coverage of both utility and non-utility property. (Staff/900, Ball/15.) PGE has proposed that this downward allocation should only be applied to categories of policies in which non-utility activity may actually be covered. There is no rationale for applying this downward departure to policies that do not apply to any non-utility activity. (PGE/2700, Piro-Tooman/9-10.)

Staff argues that it does not have enough time to consider PGE's proposal or to apply its 1.79% reduction only to those categories of insurance policies that apply to non-utility activities. This is not sufficient justification for applying this reduction to policies that do not apply to any non-utility component. Staff had (and has) adequate time to review PGE's proposal, or to propose refinements to its own approach. The Commission should not adopt Staff's plainly inaccurate approach, but instead should adopt PGE's approach, which actually attempts to differentiate between utility and non-utility components in these insurance policies.

In sum, PGE recommends that the Commission allow $8,549,902 for insurance policies, resulting in a downward adjustment to PGE's filed case of $439,815 allocable 45.5% to

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capital and 54.5% to O&M. These costs are part of the original rate case and should be part of this analysis. (*See* PGE Exhibit 2707.)

B. The Commission should reject Staff's proposed reductions for miscellaneous charges

Staff's proposes reductions to various miscellaneous charges totaling approximately $710,000. PGE has presented its arguments with respect to these charges in its testimony. (*See* PGE/2700, Piro-Tooman/12-14 and in its Opening Brief at 37-39.) For the reasons stated, PGE respectfully requests that the Commission reject Staff's proposed reduction for miscellaneous costs.

VIII. TAXES

A. Staff's property tax adjustment should be rejected

In surrebuttal testimony, Staff proposed a revenue requirement figure of $34 million for Oregon/Montana property tax expense. Staff's proposed $2 million adjustment to PGE's revised request of $36 million is based on two ill-founded adjustments. First, Staff suggests that the property taxes should be considered a function of plant-in-service, net of depreciation, rather than as a function of overall rate base. (PGE/2300, Tooman-Tinker/20.) This is wrong. In fact, property taxes are dependent on all of the assets of the company, including regulatory assets and liabilities, materials and fuel. (*Id. at* 21.) The Oregon Department of Revenue uses several methods to arrive at an assessed value which determines PGE's property tax expense. One such approach examines the capitalized income of the company. "Since PGE's income is a function of our entire rate base, it follows that property taxes are also a function of all the elements of rate base as well." (*Id.*)

Second, the level of property tax expense proposed by Staff is sufficient only if one assumes the following: (1) tax rates do not increase at all from 2007 to 2009; and (2) there is no increase in assessed value due to capital additions after January 1, 2008. Neither of these assumptions is reasonable. (*Id. at* 21-22.) PGE projects over $191 million in net capital

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additions by the end of the test year, 2009. These additions increase the assessed value to which the effective property tax rate is applied. Even assuming that property tax rates remain at their 2007 average levels in Oregon, these capital additions would increase the Oregon property tax expense in 2009 by $1.1 million. The property tax expense in Montana would similarly rise by approximately $.1 million. (*Id. at* 23.) These upward adjustments from Staff's forecast do not even include any allowance for increases in the underlying tax rate. Staff's proposed adjustment for property taxes should be rejected.

B. The Commission should set an SB 408 ratio that recognizes disallowed costs

SB 408 requires the Commission to establish certain ratios in general ratemaking proceedings, which are used to determine "taxes collected" from customers for the purpose of the SB 408 true-up of "taxes paid" to "taxes collected." We believe the Commission should consider the impact of disallowed costs in determining the tax rate and margin ratio for SB 408 purposes.

Staff argues that this approach would be inconsistent with SB 408 and the Commission decisions in the SB 408 rulemaking proceeding. We disagree. SB 408 defines "taxes collected" in terms of the effective tax rates and "net to gross" revenue ratio "as determined by the Commission in establishing rates." (ORS 757.268 (13)(e).) Nothing in SB 408 or in the implementing rules prevents the Commission from establishing these ratios in a manner that recognizes the expected profitability of the utility as a result of a general rate case.

The Commission has discretion and the authority to establish ratios that are fair and reasonable. Where the Commission has such discretion under SB 408, it has exercised its authority to avoid unwarranted and unintended consequences.[5] In this case, adjusting the margin ratio to include expenses PGE is either contractually required to incur or for costs that are likely to be incurred, but which costs have been disallowed for ratemaking purposes, is fair and

[5] *See, e.g.*, UM 1234, Order No. 07-227 at 6 (June 8, 2007) ("we note that SB 408 contains no language proscribing the Commission from accounting for SB 408 effects on utility costs when setting rate"); UE 180, Order No. 07-015 at 27 (adjusting a power cost adjustment mechanism to consider SB 408 impacts); AR 499, Order No. 06-532 at 5 (September 19, 2006) (adopting rules for the apportionment of taxes paid between parent company and the utility).

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503-221-1440

accurate. If customers are not responsible for paying the underlying expense because of a ratemaking disallowance, they should not be permitted to receive the tax benefit from that expense through SB 408. PGE is not asking the Commission to reverse the effects of its disallowances or to even eliminate the double whammy effect of SB 408. Rather, all we are asking is for the Commission to use the most accurate margin ratio based on the current rate case. Such a ratio is the most accurate measure of the expected profitability for PGE and reflects appropriate ratios "as determined by the Commission in establishing rates." Therefore PGE's proposal should be used for establishing the SB 408 "net to gross" revenue ratio.

IX. PRICING

A. Staff's seasonal pricing option is premature and unwarranted at this time

Staff's opening brief asserts that it is necessary now to implement seasonal pricing. Staff appears to believe that PGE's concerns about customer impacts, implementation and administrative issues are of no concern or consequence. We disagree. When proposing new rate structures and substantial changes to existing rate designs, the precise contours of the proposal are critically important to a successful and sustainable rate structure. Our review of Staff's proposal indicates that more work needs to be done on these proposals and that there is no need for the Commission to rush to a premature and not fully reviewed, new rate structure.

Staff's opening brief spends nearly nine pages attempting to explain its seasonal rate proposal, which in many ways departs from its earlier proposal. Some of these proposed changes are unclear and leave us uncertain as to how the various pieces fit together. This illustrates that the components of Staff's proposal are neither sufficiently developed nor understood by PGE or our customers.

We have raised concerns about the rate design impacts on time of use rates, direct access transition adjustments, and how the rates will be managed over time. (*See* PGE/2000, Kuns-Cody-Lynn/4; PGE/2800, Kuns-Cody-Lynn/5-7.) These concerns have not been answered in testimony or in Staff's opening brief. While we do not claim that implementing seasonal rates is impossible or even exceedingly difficult, we believe that Staff's proposal requires further study before it can be implemented. The various customer groups participating in this docket agree with us.

We believe it is unnecessary to rush to the type of seasonal pricing Staff proposes when the summer peak that appears to be the motive force behind Staff's proposal is more than a decade away. It is better to more fully explore the implications of Staff's proposal and to test the impact of that proposal under different scenarios. Staff has not presented any analysis that indicates how their seasonal pricing proposal provides for efficient rate schedule migration or how its proposal affects Schedule 128 transition adjustments for customers that choose market supply options either from PGE or from an ESS. We believe that at a minimum, these requirements should be fully explored before adopting seasonal pricing. The stipulation we reached with ICNU, CUB and Kroger to open a docket in 2009 will enable parties to more fully analyze and develop appropriate proposals.

Staff proposes to change PGE's pricing structure over the objections of PGE and all participating customer groups in this case because the third quarter average on-peak prices are higher than the on-peak prices in other portions of the year as forecasted for 2009. (Staff Opening Brief at 18-19.) However, Staff's updated Exhibit 502, attached to its brief, shows that third quarter on-peak prices are less than $1.50/MWH higher than in the fourth quarter. Furthermore, the overall prices are higher in the fourth quarter than in the third quarter. This hardly provides a basis for the seasonal pricing Staff advocates, especially given their lack of analysis regarding rate migration and transition adjustments. Staff's citation to PGE's IRP is unavailing. (*Id.* at 19.) Staff fails to mention that the projected dual peak (summer and winter

Tonkon Torp LLP
888 SW Fifth Avenue, Suite 1600
Portland, Oregon 97204
503-221-1440

peaks) occurs only at the end of the next decade. For the foreseeable future, PGE is projected to be a winter-peaking utility.[6]

Fundamentally, Staff's proposal provides the wrong price signals to customers. Under Staff's proposal, a customer's bill will be higher in the summer, despite the fact that higher overall prices occur in the winter months. This is true not only on a historical basis but for the foreseeable future. The third quarter of 2010 is projected to have lower mid-Columbia hub prices than both the first and fourth quarters. (Staff Cross Examination Exhibit 4).) However, if Staff's proposal is adopted, customers would incur higher bills during a period that is expected to be a lower cost period for the company. Clearly this makes no economic sense and provides inappropriate price signals.

Staff states that only on-peak prices matter, but unfortunately Staff proposes changes to Schedules 32 and 83 when those tariff energy prices are not on-and off-peak differentiated. (Staff Opening Brief at 21.) The result is that these schedules will incur higher bills in the third quarter even though the fourth quarter has higher overall projected energy prices. Indeed, the market price projections for 2010 that Staff cites clearly demonstrate that both the first and fourth quarters contained higher overall prices than the third quarter. (*See id.*; Staff Cross Exmaination Exhibit 304.) This provides perverse price signals to customers.

In addition, the precise contours of Staff's proposal are unclear. For commercial schedules (i.e., Schedules 32 and 83), Staff had proposed a seasonal differential of 1.2 cents per KWH for these non-time-of-use differentiated customers. Now in its opening brief, Staff claims that the differential is less than 1 cent per KWH. (Staff Opening Brief at 20.) As further evidence that Staff's proposals are not fully developed, Staff states that for Schedule 89 they are proposing a "super-peak/off-peak" differential "in the neighborhood of 20 mills with a shoulder-

[6] Staff is either mistaken or misled when it states that PGE's 2006 energy sales, as stated in its FERC Form 1 were higher during the Summer months in 2006. The figures Staff cites include PGE's sales for resale, not native load figures. In fact, PGE's sales to retail customers were highest in the fourth quarter, the second highest sales occurring in the first quarter. The third quarter had the third highest sales.

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peak/off-peak differential at a lower intermediate level." (Staff's Opening Brief at 25.) In its opening testimony, Staff provided Exhibit 504 that included super-peak prices that were either 24 or 25 mills per KWH higher than the off-peak prices. Now we are told that the appropriate differential is "in the neighborhood of 20 mills." At the conclusion of this rate case, the Commission will issue a final order and expect PGE to file compliance tariffs. The nature of Staff's proposals are so unclear that PGE would not know how to proceed if the Commission adopted them.

In sum, PGE supports continuation of our current and proposed practice of having the same energy prices throughout the year. The customer groups in this proceeding also support PGE's position. Staff's proposal is unwarranted and unwise. It would result in customers incurring higher bills in the third quarter and lower bills in the fourth quarter when overall energy prices are higher in the fourth quarter and lower in the third quarter. We continue to support opening a docket in 2009 to discuss marginal cost, rate design and pricing issues. In that docket, PGE, CUB, ICNU, Kroger, and Staff will be able to more fully examine Staff's proposals and alternative rate structures.

B. Low-income issues

CAPO/OECA offers no new support for its proposals. For the reasons set forth in PGE's Opening Brief and in testimony, the Commission should reject each of CAPO/OECA's specific proposals, which no other party supports.

C. The Commission should adopt PGE's decoupling proposals

The central decision before the Commission is whether to continue the current misalignment of utility customer and utility shareholder interests when it comes to energy efficiency. Oregon has a long-standing commitment, as a matter of both law and policy, to pursue all cost-effective electricity savings and avoid unnecessary expenditure on generation and grid additions. (PGE/2100, Cavanagh/5.) The Commission has an opportunity in this

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888 SW Fifth Avenue, Suite 1600
Portland, Oregon 97204
503-221-1440

proceeding to continue its long-standing efforts to align shareholder and customer interests in reducing electricity needs.

Unfortunately, the benefits of aligning utility customer and utility shareholder interests have not been addressed by the other parties. Rather, CUB, Staff and Kroger broadly oppose decoupling because they believe the proposal will shift risks between customers and the utility in a manner not to their liking. In a nutshell, the arguments opposing decoupling are, at their core statements, that the parties like the way things are now, and fail to address the more crucial question of creating a regulatory structure that aligns interests and objectives over time.

The other parties do not deny that the current regulatory structure punishes utility shareholders for effective energy efficiency and provides those same shareholders with a windfall for every incremental kilowatt hour sale above forecast loads. Staff, CUB, and Kroger simply want the Commission to ignore this core contradiction in current regulatory policy. We believe the Commission must remove this misalignment in order to promote energy efficiency and foster a sound ratemaking approach for the recovery of fixed costs.

PGE's decoupling proposal ensures that risks and rewards are balanced. For example, the decoupling mechanism is applied to weather normalized loads, meaning the utility still retains weather related risk. In addition, changes in cost are not incorporated into the decoupling adjustment, leaving cost variation as a risk for the utility. Finally, any annual adjustment rates caused by the mechanism will not exceed two percent. This provides a "circuit breaker" assuring customers that any rate impact will be relatively small.

Staff and the other parties opposing the decoupling, focus on the fact that if customers lower consumption, they can expect to see an adjustment under the decoupling mechanism that shares some of the savings from energy efficiency with the utility. (*See, e.g.*, Staff Opening Brief at 30.) Staff and the other parties do not explain why or even if this outcome is improper. The fixed costs to be recovered through the decoupling adjustment are costs PGE has actually incurred to provide utility service to its customers. The parties provide no basis for believing PGE should not recover those costs.

More important, the example ignores the benefits that accrue to customers if PGE's shareholders' incentives were in line with customers' interests when it comes to energy efficiency. The current misalignment of interests will no doubt impede the effectiveness of energy efficiency programs. Aligning PGE shareholder and customer interests will foster and increase the efficacy of those programs. That is why Ralph Cavanagh, a recognized expert in the area and no champion of shareholder interests, supports PGE's decoupling proposal. By driving increased energy efficiency, decoupling will benefit customers by reducing their electricity needs over time. The example Staff and the other parties rely upon ignores this fact and assumes, without support, that energy efficiency programs will proceed unaffected by the current misalignment of interests between utility customer and utility shareholder.

Neither Staff, CUB nor Kroger challenge the basic mechanics of our SNA decoupling mechanism. The mechanism can result in refunds and lower surcharges and is not biased in either direction. The parties opposing decoupling do not dispute this. We do not deny that our decoupling proposal is a change from the status quo. We believe that change will be a benefit to our customers by modifying the Commission's existing ratemaking policies to align utility incentives with the delivery of cost-effective energy efficiency measures.

X. CONCLUSION

We respectfully request that the Commission issue a Final Order (i) approving PGE's rate request in this docket, (ii) approving the stipulations filed in this docket; (iii) approving PGE's proposed tariffs; (iv) approving a change in PGE's underground FITNES to a ten-year cycle; and (v) authorizing the creation of a regulatory asset for the above-average generation and plant O&M expenses identified herein and its recovery over a five-year amortization period.

DATED this 4th day of November, 2008.

PORTLAND GENERAL ELECTRIC COMPANY

Douglas C. Tingey
121 SW Salmon Street, 1WTC1300
Portland, OR 97204
Telephone: 503-464-8926
Fax: 503-464-2200
E-Mail doug.tingey@pgn.com

TONKON TORP LLP

David F. White, OSB No. 01138
Direct Dial 503-802-2168
Direct Fax 503-972-3868
E-Mail david.white@tonkon.com
Paul W. Conable, OSB No. 97536
Direct Dial 503-802-2188
Direct Fax 503-972-3888
E-Mail paul.conable@tonkon.com
888 SW Fifth Avenue, Suite 1600
Portland, OR 97204-2099

Of Attorneys for Portland General Electric Company

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CERTIFICATE OF SERVICE

I hereby certify that on this day I served the foregoing **PORTLAND GENERAL ELECTRIC COMPANY'S REPLY BRIEF** by e-mail and/or mailing a copy thereof, to each party that has not waived paper service, in a sealed, first-class postage prepaid envelope, addressed to each party listed below and depositing in the US mail at Portland, Oregon.

Jim Abrahamson – Confidential
Community Action Directors of Oregon
PO Box 7964
Salem OR 97301
jim@cado-oregon.org

Kurt J. Boehm -- Confidential
Boehm Kurtz & Lowry
36 E Seventh St - Suite 1510
Cincinnati OH 45202
kboehm@bkllawfirm.com

Roger D. Colton -- Confidential
Fisher Sheehan & Colton
34 Warwick Rd
Belmont MA 02478
roger@fsconline.com

Joan Cote -- Confidential
President, Oregon Energy Coordinators Association
2585 State St NE
Salem OR 97301
cotej@mwvcaa.org

Jim Deason -- Confidential
Attorney at Law
1 SW Columbia St, Suite 1600
Portland OR 97258-2014
jimdeason@comcast.net

Patrick Hager -- Confidential
Portland General Electric
Rates & Regulatory Affairs
121 SW Salmon St
Mail Code: 1WTC0702
Portland OR 97204
pge.opuc.filings@pgn.com

Robert Jenks -- Confidential
Citizens' Utility Board of Oregon
610 SW Broadway, Suite 308
Portland OR 97205
bob@oregoncub.org

Judy Johnson -- Confidential
Public Utility Commission
PO Box 2148
Salem OR 97308-2148
judy.johnson@state.or.us

Jason W. Jones -- Confidential
Department of Justice
Regulated Utility & Business Section
1162 Court St NE
Salem OR 97301-4096
jason.w.jones@state.or.us

Michael L. Kurtz -- Confidential
36 E 7th St, Suite 1510
Cincinnati OH 45202-4454
mkurtz@bkllawfirm.com

G. Catriona McCracken -- Confidential
Legal Counsel
610 SW Broadway - Suite 308
Portland OR 97205
catriona@oregoncub.org

OPUC Dockets
Citizens' Utility Board of Oregon
610 SW Broadway, Suite 308
PORTLAND OR 97205
dockets@oregoncub.org

Kip Pheil -- Confidential
Oregon Department of Energy
625 Marion St NE - Suite 1
Salem OR 97301-3737
kip.pheil@state.or.us

Janet L. Prewitt -- Confidential
Department of Justice
Natural Resources Section
1162 Court St NE
Salem OR 97301-4096
janet.prewitt@doj.state.or.us

Douglas C. Tingey -- Confidential
121 SW Salmon
Mail Code: 1WTC13
Portland OR 97204
doug.tingey@pgn.com

S. Bradley Van Cleve -- Confidential
Davison Van Cleve PC
333 SW Taylor - Suite 400
Portland OR 97204
mail@dvclaw.com

Michael T. Weirich -- Confidential
Department of Justice
Regulated Utility & Business Section
1162 Court St NE
Salem OR 97301-4096
michael.weirich@doj.state.or.us

Scott Winkels -- Confidential
League Of Oregon Cities
Intergovernmental Relations Associate
PO Box 928
Salem OR 97308
swinkels@orcities.org

DATED this 4th day of November, 2008.

TONKON TORP LLP

By ____
David F. White, OSB No. 01138
Paul W. Conable, OSB No. 97536

Attorneys for Portland General Electric Company

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