Oregon

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August 1. 2005

Via Electronic Filing and U.S. Mail

OREGON PUBLIC UTILITY COMMISSION
ATTENTION: FILING CENTER
PO BOX 2148
SALEM OR 97308-2148

RE: OPUC Docket Nos. DR 10, UE 88, UM 989 (UE 88 Remand) - In the Matters of:

The Application of Portland General Electric Company
For an Investigation into Least Cost Plan Plant
Retirement (DR 10)

Revised Tariffs Schedules for Electric Service in Oregon
Filed by Portland General Electric Company (UE 88)

Portland General Electric Company's Application for an
Accounting Order and for Order Approving Tariff Sheets
Implementing Rate Reduction (UM 989)

Enclosed for filing in the above-captioned docket are the Public Utility Commission's DR 10, UE 88, and UM 989 Surrebuttal Testimony. This document is being filed by electronic mail with the PUC Filing Center.

/s/ Lois Meerdink

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PUBLIC UTILITY COMMISSION OF OREGON

UE 88/DR 10/UM 989
(UE 88 Remand)

STAFF SURREBUTTAL TESTIMONY OF

ED BUSCH AND BRYAN CONWAY
JUDY JOHNSON

In the Matters of:

Revised Tariffs Schedules for Electric Service in Oregon Filed by Portland General Electric Company (UE 88)

The Application of Portland General Electric Company For an Investigation into Least Cost Plan Plant Retirement (DR 10)

Portland General Electric Company's Application for an Accounting Order and for Order Approving Tariff Sheets Implementing Rate Reduction (UM 989)

August 1, 2005

CASE: UE 88 (Remand)
WITNESS: Ed Busch & Judy Johnson

PUBLIC UTILITY COMMISSION OF OREGON

STAFF EXHIBIT 300

Surrebuttal Testimony

August 1, 2005

Q. PLEASE STATE YOUR NAMES AND POSITIONS.

A. My name is Ed Busch. I am the Administrator of the Electric & Natural Gas Division in the Utility Program of the Public Utility Commission of Oregon (OPUC).

My name is Judy Johnson. I am the Program Manager for Electric & Natural Gas Revenue Requirements in the Utility Program of the OPUC.

Q. HAVE YOU PREVIOUSLY FILED TESTIMONY IN THIS PROCEEDING?

A. Yes. Our direct testimony was filed as Staff Exhibit/100. Our witness qualifications are shown on Staff Exhibit/101.

Q. WHAT IS THE PURPOSE OF YOUR SURREBUTTAL TESTIMONY?

A. The purpose of this testimony is to address issues Utility Reform Project (URP) witnesses raise in their direct testimony and PGE witnesses discuss in the company's rebuttal testimony.

Q. WHAT APPROACH DID URP EMPLOY TO CALCULATE AN AMOUNT OF REFUND THE COMMISSION SHOULD ORDER IN THIS PROCEEDING?

A. As shown in URP/200, Lazar/16 and 202/1, URP proposes a refund amount due ratepayers of $806 million, as of January 1, 2006. Mr. Lazar calculates this amount by summing: (a) the amount of Trojan return on investment included in rates from April 1, 1995 through September 30, 2000 (the effective date of the UM 989 settlement); (b) an amount for deferred taxes as of October 1, 1995; and (c) compound interest on those amounts through December 31, 2005. As Mr. Lazar states on page 13 of his testimony: "I view the purpose of this phase of this proceeding to determine how much return (profit) PGE received on Trojan during the period covered by UE-88, and adjusting that to reflect accrued interest to be refunded along with the overcharge."

Q. DO YOU AGREE WITH URP'S APPROACH?

A. No. The Commission established the scope of the first phase of this proceeding as addressing the question of "What rates would have been approved in UE 88 if ORS 757.355 had been interpreted to prohibit a return on Trojan." Mr. Lazar's calculation of how much PGE may have over-recovered from 1995 to date for Trojan investment provides no information to answer this question. For that reason, we have not attempted to evaluate the calculations and assumptions underlying URP's approach.

Similarly, URP witness Meek appears to suggest that the Commission, in reaching its decision in this proceeding, consider that Enron paid a "huge premium" over PGE's market value in 1997, PGE significantly overearned its return from 1995 through 2000, and during the same period charged ratepayers $80.1 to $86.1 million annually for income taxes that were not paid to federal or state governments. (URP/204, pages 9-14.) Even if the Commission would take these factors into account in a ratemaking decision—which we do not believe it should—they clearly occurred after the UE 88 determination and could not have affected that decision.

Q. ON PAGES 15 AND 16 OF URP EXHIBIT 204, MR. MEEK ARGUES AGAINST THE CLASSIFICATION OF A PORTION OF THE APRIL 1, 1995 TROJAN BALANCE AS PLANT IN SERVICE, CLAIMING THAT THIS IS "NOT THE 'UTILITY SERVICE' REQUIRED BY ORS 757.355." DO YOU

AGREE WITH MR. MEEK'S CHARACTERIZATION OF THAT PORTION OF THE TROJAN BALANCE?

A. No. These are clearly legitimate costs on which investors should earn a return. Staff makes its position clear in Staff/100, Busch-Johnson/16-17 that a portion of the Trojan investment continued to be plant in service, because it was used and useful in carrying out activities related to safety, environmental protection or decommissioning. Plant in service logically includes the date plant is placed into utility service until the date the plant is fully decommissioned. To do otherwise would place at risk the full recovery of the plant and equipment necessary to the decommissioning of hydro and thermal sites and the restoration and reclamation of mine sites. The recognition of this plant and equipment as in-service also encourages appropriate decision making by utilities. Without this recognition, utilities may have the incentive to avoid cost-effective investments that have a lengthy decommissioning.

Q. PAGE 5 OF PGE/6800 STATES THAT, FOR CONSIDERATION OF STEAM GENERATOR COSTS IN THE NET BENEFITS TEST, IT IS UNLIKELY "THE COMMISSION WOULD HAVE ALLOWED NONE OF THOSE COSTS IN RATES" HAD IT KNOWN OF THE COURT APPEALS DECISION. DO YOU AGREE?

A. No. Our position is that the Commission has no basis on which to change its decision to exclude those costs from the net benefit test. Unlike the accounting of the decommissioning-related assets--which the Commission originally intended should be fully recovered--modifying the treatment of the steam generators would be contrary to the position that PGE, not ratepayers, should "pursue remedies against Westinghouse." While PGE correctly points out that the Commission could have exercised its discretion differently had it known of the Court's conclusion, we can think of no valid reason it would have done so. Simply changing the Commission's decision regarding responsibility for the steam generator costs because a return on investment is not allowable would circumvent ORS 757.355, as interpreted by the Court.

Q. ON PAGE 6, PGE STATES THAT THE COMPANY PURSUED REMEDIES AGAINST WESTINGHOUSE FOR THE STEAM GENERATORS THROUGH LITIGATION REGARDING REPLACEMENT POWER COSTS. DOES THIS SUPPORT RECONSIDERATION OF THE STEAM GENERATOR COSTS IN THE NET BENEFITS TEST?

A. No. We do not know whether PGE could have successfully pursued remedies against Westinghouse related to the faulty steam generators causing premature retirement, in addition to seeking payment related to replacement power costs. However, we believe that a $4 million litigation settlement credited to customers does not begin to justify reconsideration of the Commission decision to exclude over $180 million in replacement steam generators in the net benefits test. As PGE stated in its original testimony, "The $187 million . . .dwarfs the amount PGE was ultimately able to recover..."

Q. ALSO ON PAGE 6, PGE PROPOSES THAT THE COMMISSION USE "REGULATORY POLICY AND, PERHAPS, LEGAL INTERPRETATION" TO CONCLUDE THAT THE PROFIT PRECLUDED BY THE COURT OF

APPEALS MEANS THE COST OF COMMON EQUITY, NOT THE COMPANY'S OVERALL COST OF CAPITAL? SHOULD THE COMMISSION ADOPT PGE'S PROPOSAL?

A. In our direct testimony, we recommended the Commission not consider this issue, because none of PGE's revenue requirement scenarios—and neither of staff's alternatives—rely on PGE's proposed interpretation of "profit". If the Commission decides to address this issue, however, we note that in its 1998 opinion in *Citizens' Utility Board, et al. v. PUC*, 154 Or App 702, 707(1998), the Oregon Court of Appeals observed that PGE had agreed that the issue presented to the court in that appeal was "whether PGE's rates may include the rate of return component, or are instead limited to the recovery of the declining principal amount of the undepreciated Trojan investment." In other words, to the extent that the Court of Appeals concluded that the Commission could not authorize PGE to earn a return on its undepreciated investment in Trojan, the court intended to mean *any* return on Trojan investment, whether it be classified as debt or equity.

Q. DOES THIS CONCLUDE YOUR TESTIMONY?

A. Yes.

CASE: UE 88 (Remand)
WITNESS: Bryan Conway

PUBLIC UTILITY COMMISSION OF OREGON

STAFF EXHIBIT 400

Surrebuttal Testimony

August 1, 2005

Q. PLEASE STATE YOUR NAMES, BUSINESS ADDRESS AND POSITION.

A. My name is Bryan Conway. My business address is 550 Capitol Street NE, Suite 215, Salem, Oregon 97301-2551. I am the Manager of the Economic & Policy Analysis Program of the Public Utility Commission of Oregon (OPUC).

Introduction and Summary

Q. WHAT IS THE PURPOSE OF YOUR TESTIMONY?

A. This testimony responds to the testimony and exhibits of the Utility Reform Project (URP) sponsored by Messrs Meek and Lazar and respond to URP's recommended Adjusted Rate of Return Methodology (ARRM).

Q. HAVE YOU PREPARED ANY EXHIBITS?

A. Yes. My Witness Qualifications Statement is attached as Exhibit Staff/401, Conway/1.

Q. PLEASE SUMMARIZE YOUR CONCLUSIONS AND RECOMMENDATIONS.

A. I conclude that URP's ARRM is flawed and is inconsistent with past Commission practice.

Summary of URP's ARRM

Q. PLEASE DESCRIBE URP'S ARRM.

A. URP's ARRM makes an additional adjustment to PGE's rates based on a change to the authorized capital structure that URP claims would have occurred if Trojan had been immediately written off.

Q. HOW IS URP'S ARRM CALCULATED?

A. URP calculates the change in total return by multiplying PGE's then-authorized rate of return by the change in rate base that would have occurred if Trojan had been written off PGE's books after its removal from service. The product of this calculation is $206 million. URP next assumes that the $206 million would change PGE's percentage of equity from 46.47 percent to 40.46 percent.

Discussion

Q. DO YOU AGREE PGE WOULD HAVE REDUCED EQUITY IF IT HAD IMMEDIATELY WRITTEN OFF TROJAN?

A. Yes. PGE's actual capital structure would have had a lower percentage of equity than if PGE had not written off Trojan.

Q. DO YOU AGREE THIS WRITE OFF WOULD HAVE RESULTED IN A LOWER AUTHORIZED RATE OF RETURN FOR PGE?

A. No. I don't believe it is reasonable to assume PGE would have been granted a lower overall rate of return due to a reduced percentage of equity as described by URP. First, the Commission adopted a settlement between Staff and PGE that set forth the capital structure and authorized returns. Second, the analysis supporting the stipulation was based on a variety of techniques and a sample of utilities, not PGE on a stand-alone basis. Third, the one-year write-off would not be viewed as having made a perpetual change in PGE's capital structure and indicative of future time periods. And, finally, based on the Commission Order No. 95-322, the percentage of equity adopted was based on a "target" or "hypothetical" capital structure, not PGE's actual capital structure at a specific point in time.

Q. PLEASE ELABORATE ON YOUR FIRST REASON.

A. In Order 95-322, the Commission adopted a stipulation that identified the cost of capital and the capital structure.[1] Term 12 of the stipulation reads, "[i]f any issue covered by this Stipulation or related to issue S-0 is challenged by someone not a party to this Stipulation, Staff and PGE agree to support and argue in good faith for the Commission's approval of all of the provisions of this stipulation." Term 14 reads, "[i]f the Commission rejects any portion of this Stipulation, Staff or PGE may withdraw from the Stipulation in its entirety."

If Trojan would have been removed from service during the course of the case, the parties to the Stipulation would have had to change their stipulated capital structure in order to recommend something different to the Commission. Further, if the Commission had unilaterally changed the capital structure as URP recommends, both Staff and PGE would have been free to argue for their initial positions. The Commission may have been persuaded by PGE that a higher rate of return would have been necessary.

Q. PLEASE ELABORATE ON YOUR SECOND REASON.

A. The testimony supporting the cost of capital and capital structure was based on a sample of utility companies, not PGE on a stand-alone basis. Because both the DCF models and the CAPM models sponsored by Staff and PGE relied on a large cohort sample, the impact of any change to one of those companies would have been minor since the cost of capital was set based on the overall sample.

Q. PLEASE ELABORATE ON YOUR THIRD AND FOURTH REASONS.

A. The one-year write off of Trojan recommended by URP should not have resulted in the Commission authorizing a capital structure assuming $206 million less

[1] The stipulation can be found at Appendix E of Order 95-322.

equity because the write-off would be considered non-recurring in nature. The authorized capital structure should be the structure that when coupled with the costs of capital results in a fair and reasonable rate of return. This fair and reasonable rate of return should be judged by the return necessary for the period rates will be in effect. Additionally, the testimony supporting the capital structure that was adopted indicated that the authorized capital structure was a "target," not PGE's actual capital structure. Also, PGE indicated that it was taking steps to reach its target by reducing its dividend and issuing equity. PGE's witness Warren Winter testifies, "[w]e have and are taking some strong steps to restore the financial health of the Company."[2] This indicates that the capital structure was a "hypothetical" capital structure, and not an estimate of PGE's current capital structure.

Q. IF THE COMMISSION HAD ADOPTED A LOWER PERCENTAGE OF EQUITY FOR PGE'S AUTHORIZED CAPITAL STRUCTURE, WOULD IT BE REASONABLE TO ASSUME THAT PGE'S COST OF EQUITY AND DEBT REMAIN CONSTANT, AS URP ASSUMES?

A. No. The Commission has addressed this most recently in Order 01-777 at page 36. In this order the Commission stated,

> It is well understood by finance practitioners and theoreticians that the cost of equity drops as the percentage of common equity in the capital structure increases. Because the average amount of common equity in the capital structure of the comparable group of electric companies was 45.14 percent compared to 52.16 percent for PGE, it necessarily follows that PGE has a lower cost of equity. PGE's capital structure is therefore less risky, and its cost of common equity should be adjusted accordingly.

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[2] See Appendix C page 11 of 17 to Order 95-322.

As the Commission stated, the cost of equity is inexplicably linked to the percentage of equity in the capital structure. If the Commission were to reduce the authorized percentage of equity in PGE's capital structure by adopting PGE's actual capital structure at the time, it would have needed to increase the cost of equity it authorized for PGE, all else equal. URP's ARRM positions are not consistent with using a hypothetical capital structure, a broad sample of utilities and multiple methods of estimating the cost of equity, the non-recurring nature of the Trojan write-off, and PGE's efforts to reduce dividends. URP's ARRM positions are not supportable.

Q. DOES THIS CONCLUDE YOUR TESTIMONY?

A. Yes.

CASE:	UE 88 (Remand)
WITNESS:	Bryan Conway

PUBLIC UTILITY COMMISSION
OF
OREGON

STAFF EXHIBIT 401

Witness Qualifications Statement

August 1, 2005

WITNESS QUALIFICATION STATEMENT

NAME: Bryan A. Conway

EMPLOYER: Public Utility Commission of Oregon

TITLE: Program Manager, Economic & Policy Analysis Section

ADDRESS: 550 Capitol Street NE Suite 215, Salem, Oregon 97310.

EDUCATION:

B.S. University of Oregon, Eugene, Oregon
Major: Economics; 1991

M.S. Oregon State University, Corvallis, Oregon
Major: Economics; 1994

In addition, I have completed all of the required and elective coursework for a Ph.D. in economics from Oregon State University. My fields of study were Industrial Organization and Applied Econometrics.

EXPERIENCE: Starting in October 1998, I have been employed by the Public Utility Commission of Oregon. I am currently the Program Manager of the Economic & Policy Analysis Section. My responsibilities include leading research and providing technical support on a wide range of policy issues for electric, telecommunications, and gas utilities. I have testified before the Commission on policy and technical issues in UG 132, UE 115, UE 116, UE 165 and have been the Summary Staff Witness in UP 158, UP 168, UP 165/170, UX 27, UX 28, UM 967, UM 1041, UM 1045, and UM 1121.

From December 1994 to October 1998, I worked for the Oregon Employment Department as a Research Analyst in their Research Section. Duties included leading research projects on various policy issues involving labor economics and information systems.

OTHER EXPERIENCE: I am currently a faculty member of the University of Phoenix teaching graduate and undergraduate economics courses.

From January 1998 through September 2000, I was a part time instructor at Linn-Benton Community College teaching principles of economics.

From July 1992 through June 1994, I was a graduate teaching assistant at Oregon State University teaching introductory principles of economics.

UE 88
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CERTIFICATE OF SERVICE

DR 10, UE 88, UM 989
(UE 88 Remand)

I certify that I have this day served the foregoing document upon all parties of record in this proceeding by delivering a copy in person or by mailing a copy properly addressed with first class postage prepaid, or by electronic mail pursuant to OAR 860-13-0070, to all parties or attorneys of parties.

Dated at Salem, Oregon, this 1st day of August, 2005.

/s/ Lois Meerdink

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