BEFORE THE PUBLIC UTILITY COMMISSION

OF OREGON

DR 10/UE 88/UM 989

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)	STAFF'S OPENING POST HEARING BRIEF (PHASE I)

INTRODUCTION

Staff of the Public Commission of Oregon ("Staff") submits its Opening Brief regarding Phase I of this proceeding. Based on the ALJ's August 31, 2004, Ruling, Commission Order No. 04-597, and Commission Order No, 05-091, Staff understands that Phase I involves:

> [A] retrospective examination of what rates would have been approved in UE 88 if the Commission had interpreted the authority delegated to it by the legislature in ORS 757.355 to not allow a return on investment in retired plant.

Order No. 04-597 at 5. While this proceeding is limited to those "aspects of the rate-making process in UE 88 that are affected by the Court of Appeals' statutory interpretation of ORS 757.355," *id.* at 6, the Commission has also acknowledged that "we must engage in ratemaking in order to set end rates that comply with the pertinent statutes, including ORS 757.355 as interpreted by the Court of Appeals, and ORS 757.020 requiring just and reasonable rates." *Id.* The Commission noted three separate elements of the UE 88 rate determination that might change with the understanding that there could not be any return on investment in Trojan: (1) recovery period for Trojan; (2) cost of capital effects; and (3) the

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application of the net benefits test. The Commission also stated that parties could raise other issues or factors as long as they are consistent with the Commission's responsibility to set just and reasonable rates. In other words, parties may make recommendations regarding the revenue requirement decision the Commission would have made as of April 1, 1995 (the effective date of Order 95-322), had the Commission known it was prohibited from approving rates that included a return on the retired Trojan plant investment.

Based on Staff's review and analysis in this first phase of these proceedings, we make the following major conclusions:

1. PGE's proposed structure for evaluating "What rates would have been approved in UE 88 if ORS 757.355 had been interpreted to prohibit a return on Trojan" was to compare the revenue requirement of alternative scenarios against actual rate case results over the period April 1, 1995 through September 30, 2000. Staff agrees this analytical structure provides a rational basis for judging whether the original UM 989 decision was appropriate.

2. Staff disagrees that PGE's three revenue requirement approaches (scenarios) are reasonable for Commission consideration. Instead, staff recommends the Commission consider PGE's Approach II with Staff's modifications or Staff's alternate approach. These two scenarios reflect what we believe the Commission most likely would have concluded to meet, as closely as reasonably possible, the objectives of intergenerational equity, acceptable rate impacts, and maintaining PGE's financial integrity. (*See* Staff/102, Busch-Johnson/1 for a summary of the revenue requirement elements for the scenarios presented by PGE and Staff).

3. Staff disagrees with URP's proposed approach in this phase of the proceedings. URP's calculation of a refund amount due ratepayers provides no information to assist the Commission in determining what rates would have been approved in UE 88 had the Commission known it could not include a return on Trojan investment.

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I. PGE's Recommended Criteria

Staff generally agrees with the criteria identified by PGE that the Commission should use in evaluating factual and policy decisions in UE 88 and UM 989. PGE suggests that the Commission decision should: (1) encourage electric utilities to analyze and make resource decisions that provide an adequate supply of energy at least cost to both the utility and its customers; (2) equitably allocate the costs and benefits of resource decisions to customers over time; and (3) preserve the utility's financial integrity and retain the ability to attract debt and equity capital at reasonable cost. (*See* PGE Exhibit 6000/Lesh/14-18; Staff/100/Busch-Johnson/4-5.)

Regarding the first and third criteria, utilities should have the incentive to acquire the resources needed to serve customers at the least cost. If a utility performs an analysis demonstrating that acquiring a new resource to replace an existing, uneconomic resource will result in lower costs for customers—including recovery of the undepreciated cost of the uneconomic resource—the utility should take that action.[1] If the Commission then required the utility to recover the uneconomic investment over a period of time without a return on investment (rather than "immediately"), the utility's investors would be short-changed through the loss of opportunity cost on their funds. Depending on the period of recovery and magnitude of the lost return on investment, investors might view such treatment as increasing risk, which could lead to higher costs of capital and increased rates in the future. As Ms. Lesh points out, the potential for these effects would provide the utility little incentive to take the proper resource action.

The second criteria, equitably allocating benefits and costs of a resource over time, can conflict with the first criterion that suggests immediate recovery of the retired investment. In the

[1] This example assumes that a resource that was prudently acquired has, through no fault of the utility, become uneconomic compared to other alternatives. If a utility, during the course of operating the resource, were to make imprudent decisions or the Commission were to otherwise determine that certain costs were not recoverable (as with Trojan steam generator investment— *see* Order 95-322 at 60-63), those amounts would be excluded from the cost-benefit analysis.

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case of Trojan, the cost-benefit study performed in UE 88 covered the costs of the plant and alternative resources over the projected life of the plant (ending in the year 2011). That time frame is reasonable, because we would expect customers over the entire 1995-2011 period to be affected by the decision to either close or continue to operate the plant. In setting recovery of the retired investment in UE 88 on that basis, the Commission adhered to the "matching costs and benefits" principle.

II. Additional Rate Impacts

Staff believes that the Commission would have made other rate adjustments to minimize the effect of Trojan not earning a rate of return. Staff believes that the Commission would have allowed a moderate level of additional increase in rates with the intent of minimizing the amount of "return on" PGE loses, and would have spread the rate impact over a number of years. For example, the Commission has allowed recovery of PGE's, PacifiCorp's and Idaho Power Company's 2001 deferred excess power costs over several years.[2] While the annual amortization amounts were, in fact, limited by ORS 757.259, the multi-year recovery represents sound policy. To mitigate the loss of return on investment, we might expect the Commission to allow rapid recovery of Trojan but at the same time make other adjustments to mitigate rate shock.

Staff also believes that if the Commission had known that a return on abandoned plant could not be included in revenue requirements, it would have allowed for a rapid recovery on Trojan. The Commission's previous decisions regarding Trojan cost recovery suggest the Commission would have attempted to make PGE whole for ratepayers' share of investment retired for economic reasons. In Docket DR 10, Order No. 93-1117, the Commission stated, "After review, the Commission may decide that PGE is entitled to full recovery of unrecovered plant costs, or it may determine that some cost sharing should occur between customers and investors."

[2] *See, e.g.* PGE Dockets UM 1008/1009 and UE 136, PacifiCorp Dockets UM 995, UE 121 and UE 127, and Idaho Power Dockets UM 1007, UE 123 and UE 131.

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In its subsequent rate case decision in UE 88, the Commission found that, after the combined disallowance of the negative net benefit and post-1991 disallowances, recovery of 87 percent ($340.2 million pre-tax) of remaining Trojan investment was in the public interest. (*See* Order No. 95-322 at 52.) By authorizing recovery of the investment over the original remaining life of 17 years and including a return on the undepreciated balance in rates, the Commission explicitly approved recovery of the present value of $340.2 million. To argue in this remand proceeding that the Commission would have made a ratemaking decision in UE 88 that resulted in a significantly different recovery amount is inconsistent with the original decision.

Moreover, the Commission supported this view in its UM 989 decision, Order 02-227 at 10-11:

> The Commission could determine that if Trojan should not have been included in rate base, PGE should have recovered the entire Trojan balance immediately instead of over 17 years, as provided in Order No. 95-322. This would provide PGE and customers with the same outcome as Order No. 95-322, and PGE would not owe refunds. The Court of Appeals decision expressly did not address this issue. *Id.* At 712 n.5.
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> Contrary to URP's position, we believe that the "no refund" outcome is consistent with the public interest. In Order No. 95-322 at 2, we expressed the goal of holding customers harmless for the premature closure of Trojan while also providing PGE with the appropriate incentives. If we required PGE to give refunds (leaving aside the fact that we have no power to do so) utilities would have an incentive to continue to operate plants past their economic or efficient useful lives.

In sum, these Commission orders suggest that the Commission intended that PGE should recover the value of customers' share of remaining Trojan investment in rates. Staff expects that the Commission, in revisiting its UE 88 decision, would allow PGE to recover Trojan expeditiously so as to minimize loss of return on investment. At the same time, the Commission might well have adjusted other cost elements to keep rates reasonably stable.

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III. PGE's Proposed Approach and Analysis

PGE offers three separate scenarios regarding what rates the Commission might have approved in UE 88 if ORS 757.355 had been interpreted to prohibit a return on Trojan.[3] Each scenario consists of a different combination of a number of elements modified from UE 88, including amortization period for undepreciated Trojan investment, return on common equity and capital structure, calculation and application of the net benefits test, classification of certain Trojan components as plant-in-service, amortization period for certain regulatory assets and liabilities, and treatment of forecasted net variable power costs. PGE refers to these elements as "building blocks."

In each case, PGE's revenue requirement is higher over the five and one-half-year study period than PGE's actual revenue requirement during this period by a range of $19.0 million to $65.1 million. In addition, the "balance owed" PGE on September 30, 2000, ranges from $183.5 million to $275.0 million. Therefore, under each approach, PGE concludes that rates would be fair and reasonable, there were no excess payments made by customers during the five and one-half years ending September 30, 2000, and the customer liability at that date was greater than the actual amount of $180.5 million, supporting the original UM 989 decision. (*See* PGE Exhibit 6000 at 40 and PGE Exhibit 6200 at 28, 31 and 34.)

For each scenario, PGE provides a five and one-half-year incremental cost analysis, from April 1, 1995, the effective date of UE 88 rates, through September 30, 2000, the effective date of the UM 989 rates. The analysis compares the revenue requirement change for the particular scenario (the sum of the revenue requirement for each element or building block modified) to the actual revenue requirement for those elements over the five and one-half year period. Note that, although we will refer to the "UE 88 revenue requirement," the Commission's revised revenue requirement decision on certain elements would affect not only UE 88 (effective April 1, 1995),

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[3] PGE summarizes three different approaches or scenarios on pages 26-34 of PGE Exhibit 6200. The spreadsheet analysis for each of these approaches is shown on pages 1-3 of PGE Exhibit 6202.

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but also the revenue requirement in UE 93 (November 28, 1995) and UE 100 (December 1, 1996).

PGE then calculates a "Derivation of Balance owed PGE at 9/30/2000" for each of its three scenarios. This calculation consists of the regulatory assets and revenue requirement effects[4] that would have existed at the time of the UM 989 decision if that particular scenario had occurred. PGE refers to the balance owed as its balance sheet. The balance at September 30, 2000, under each scenario is intended to inform the Commission's determination in this remand proceeding regarding UM 989.

Staff agrees with the basic structure of PGE's analysis which compares revenue requirements of a particular scenario with actual rate case results over the five and one-half-year period. This accomplishes two objectives. First, replacing actual UE 88 rates with rates based on different elements will allow the Commission to retroactively exclude from PGE's revenue requirement any unlawful return on retired Trojan. Second, replacing UE 88 rates with rates based on decisions the Commission would likely have made had it known that allowing a return on Trojan was unlawful will enable the Commission to determine whether sufficient regulatory assets would have existed on September 30, 2000, to have allowed it to make the same decision in UM 989. Staff points out that customers would no longer receive a benefit from the UM 989 settlement if the regulatory assets at that date were less than $164.1 million. (*See* Staff/100, Busch-Johnson/10, 24.)

A. Staff Supports PGE's second approach with adjustments

Staff believes that PGE's second approach, with Staff's proposed adjustments, meets the criteria of encouraging economic resource decisions, ensuring a high degree of intergenerational equity and preserving PGE's financial integrity. Moreover, since the year-to-year revenue requirements are very similar to what the Commission actually authorized, this approach does

[4] The "balance owed" figure includes both the difference and the associated time value of money on the difference, calculated at PGE's rate of return.

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not cause material incremental rate impacts.

Under PGE's second approach, PGE uses a one-year recovery for retired Trojan investment but also assumes the Commission would make the following adjustments to several other elements of the original UE 88 revenue requirement:

- Restore (for recovery) the $26.8 original disallowance from the UE 88 net benefits test, based on a positive net benefit result that allows recovery of steam generator investment in the closure scenario.
- Leave $80.2 million of Trojan investment as Plant in Service rather than abandoned, because certain assets provide service in the form of safety, environmental protection or decommissioning. These assets would be amortized on a 17-year schedule.
- Reduce the remaining retired, undepreciated Trojan assets by the $111 million remaining customer share of the Boardman gain (which the Commission ordered PGE to amortize to customers over 27 years in Dockets UE 47/48, Order No. 87-1017).
- Authorize a return on equity of 11.85 percent, an increase of 0.25 percent.
- Defer $138 million of PGE's test period net variable power costs for recovery over the subsequent ten years, to improve matching of the costs and benefits of Trojan and achieve better rate stability.
- Recover certain regulatory assets—the AMAX termination payment, pre-UE 88 deferred power costs, and SAVE incentive—over ten years.

The result of this approach is that PGE's revenue requirement would have been $16.1 million higher in the first 12 months beginning April 1, 1995, and $19.0 million higher over the five and one-half year study period. The balance owed PGE at September 30, 2000, consisting of the remaining balance for Trojan plant, regulatory assets and deferred power costs, revenue requirement difference and associated interest, would have been $198,222.

Staff agrees with classification of $80.2 million of Trojan investment as plant in service to be recovered over 17 years, and offsetting the remaining Trojan balance by the Boardman gain with recovery over one year. Staff also agrees the Commission might have deferred a portion of

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first year net variable power costs and amortized these costs[5], along with the three regulatory assets (AMAX, pre-UE 88 deferrals and SAVE incentives) over a 10-year period.

Staff supports the classification of $80.2 million in Trojan investment as plant in service for several reasons. First, while the assets in question no longer provided service related to generating electricity after Trojan shut down, they were not abandoned. Rather, they were "used and useful" in carrying out activities related to safety, environmental protection or decommissioning. Order No. 95-322 at 53 acknowledged that the assets "provide the service necessary for safety and asset preservation pending decommissioning and dismantling of the plant." It is hard to argue that these are not legitimate and necessary utility services.

Second, following the closure of Trojan, PGE requested the FERC Chief Accountant's approval to continue to use Account 101, Plant in Service, "for Trojan assets that will continue to operate and provide utility benefit following the plant closure." The Chief Accountant approved PGE's request in April 1993. (*See* PGE Exhibit 6301), and PGE's financial statements reflected that accounting.

Third, as PGE points out, in UE 88 "neither Staff nor the Commission explicitly disagreed with PGE's method to identify Trojan plant-in-service." Using that same method for this proceeding, PGE performed an asset-by-asset study that identified which Trojan assets, or portion of assets, were in fact used and useful from 1995 going forward. The company's study, shown in PGE Exhibit 6303, identified $113.6 million net plant in service. This amount exceeds the $80.2 million level PGE requested be classified as plant in service in UE 88 and again in this remand proceeding.

Finally, Order 95-322 at 53 stated the Commission's belief that "[b]ecause both [FERC 101 and 182.2] accounts are included in PGE's rate base, transferring investment between the accounts will not affect the rate base." In other words, it didn't make a difference in the original

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[5] As we discuss later, the Commission would need to conclude that deferral and amortization of a portion of test period power costs is consistent with the Court of Appeals' 1998 opinion.

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UE 88 decision whether Trojan assets were classified as plant in service or abandoned plant. Staff believes that it is highly likely the Commission would have allowed these assets to remain in plant in service had it known that plant which was truly "abandoned" could not be included in rate base and earn a return.

Staff agrees with the PGE that it would be reasonable to reduce the remaining Trojan investment by the amount of the Boardman gain because it would improve the matching of costs and benefits among generations of customers, as well as improve rate stability. In two separate decisions, the Commission spread the rate effect of recovering the undepreciated Trojan investment (cost to customers) over a period ending in 2011, and customers' share of the Boardman gain (credit to customers) over a period ending in 2013. By offsetting Trojan investment with the balance of the Boardman gain in a revisited UE 88 decision, the Commission would achieve roughly the same objective.

We agree with PGE that the Commission might have deferred a portion of the first year power costs and amortized those costs, along with regulatory assets over ten years. Staff believes that for rate stability and intergenerational equity purposes, the Commission could have exercised its discretion and determined that a portion of power costs should be deferred and amortized with certain regulatory assets over an extended period of time. Increasing rates substantially for customers in one year while reducing rates significantly for customers in subsequent years would be poor regulatory policy.

Staff notes, however, that test period power costs typically are an expense rather than an asset. While deferral and amortization of test period expense amounts would smooth the rate effect of rapid recovery of Trojan, Staff is uncertain whether the treatment would be consistent with the intent of the Court of Appeals' decision.

Staff does not agree that the Commission would have authorized a higher rate of return on equity. In Staff/200, witness Thomas Morgan explains why the Commission would have been unlikely to increase PGE's cost of capital. A single, short-term event, with minor financial

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impact associated with a one-year amortization period, should not affect PGE's long-term cost of capital. (*See* Staff/200, Morgan 17-20, 25-26.) Removing PGE's assumed 0.25 percent higher ROE results in a $24.5 million lower revenue requirement over the period. (*See* PGE response to Staff data request 56.)

Staff disagrees with PGE that the Commission would restore the entire $26.8 million disallowance from the net benefits test on the basis that steam generator replacement costs would be recoverable in the closure scenario. Instead, we recommend restoration of $17.66 million of the original disallowance. This amount represents the "return on" lost due to recovering the remaining Trojan investment, net of the plant in service amount, over one year.

Staff disagrees with PGE's proposal that the Commission reverse its disallowance of the $183.1 million steam generator replacement costs for purposes of the net benefits test. Staff believes it would be inconsistent for the Commission to find that it would not have allowed recovery of these costs in rates if the plant continued to operate, yet consider them as savings in the net benefits test in the closure scenario.

In Order 95-322 at 62, the Commission stated: "Even if PGE is faultless, PGE is better situated to pursue remedies against Westinghouse than its ratepayers are." In the current proceeding, PGE attempted to address this issue: "Subsequent to UE 88, PGE resolved its claims against Westinghouse. The settlement of that litigation resulted in a payment of about $4 million by Westinghouse, which PGE credited to customers in the UM 989 stipulation. The $187 million excluded by the Commission from the net benefits test dwarfs the amount PGE was ultimately able to recover from the manufacturer." (*See* PGE Exhibit 6000 at 27.) PGE's statement, however, is misleading. Staff understands that the $4 million related to a settlement for replacement power costs, <u>not</u> defective steam generators that caused the plant to be shut down prematurely. Staff is unaware of any effort made by PGE to pursue remedies against Westinghouse for the faulty steam generators.

While Staff agrees that the Commission might have exercised its discretion differently

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and considered steam generator costs in the net benefits test, we believe there is no basis on which to do so. Moreover, changing the Commission's decision regarding responsibility for the steam generator costs because a return on Trojan investment is not allowable would circumvent ORS 757.355.

Staff proposes that the lost return on investment be calculated without recognizing the Boardman gain offset. Staff believes that including the Boardman offset in the calculation of the net benefit would mistakenly incorporate non-Trojan elements. Consideration of any offsets or other ratemaking adjustments should occur outside of the net benefits test and only after the Commission has determined the amount of Trojan investment that is recoverable.

In sum, PGE's Approach II, with Staff's proposed adjustments, meets the criteria of encouraging economic resource decisions, ensuring a high degree of intergenerational equity, and preserving PGE's financial integrity. Since the year-to-year revenue requirements are very similar to what the Commission actually authorized, this approach does not cause material incremental rate impacts. With the two changes noted above, PGE's revenue requirement would have been $8.6 million lower than what actually occurred over the five and one-half year study period, and the "Balance owed PGE" on September 30, 2000, would have been $158.9 million. (*See* Staff/102,Busch-Johnson/2.) We believe this is a likely scenario.

B. Staff opposes PGE's first approach

Staff does not support PGE's first approach under which the $340.2 million of net Trojan investment is assumed to be amortized over one year, rather than the 17-year recovery period actually authorized in UE 88.[6] In addition, this scenario allows recovery of $23.1 million of the original $26.8 million disallowed in Order No. 95-322 at 52 ($20.4 million after-tax disallowance), on the basis that net benefits test would be adjusted to reflect the loss of return on

[6] The $340.2 million is the pre-tax Trojan investment equivalent of $263.9 million after-tax investment at 4/1/95, which in turn is comparable to the $250.7 million after-tax investment (the average of the 1995 and 1996 test period in UE 88) the Commission allowed PGE to recover in Order 95-322. As does PGE in its testimony, we refer to pre-tax figures except as noted.

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Trojan over one year. The result of this approach is that PGE's revenue requirement would have been $285.4 million higher in the first 12 months beginning April 1, 1995, and $65.1 million higher over the 5.5-year study period. The balance owed PGE on September 30, 2000, consisting of the revenue requirement difference and associated interest, would be $183,492.[7]

Staff opposes this approach because it believes that a one-year recovery period for Trojan, with no attempt to spread other costs over time, would severely violate PGE's second criteria, equitably allocating costs and benefits to customers over time. The likelihood of the Commission approving a one-year increase of $285 million (representing another 30.5 percent increase over UE 88 sales revenues for test year 1995), is small. Raising rates by 30 percent simply to recover Trojan quickly, then lowering them by a like amount a year later, is clearly adverse to rate stability.[8] While a two- or three-year amortization, for example, might reduce the rate impact to a more acceptable level, it would also force PGE to absorb even more return on investment.

C. Staff opposes PGE's third approach

Staff also opposes PGE's Approach III, which is based on a 17-year recovery of both the net Trojan investment classified as abandoned plant and 20 percent of a $256 million positive result for the net benefit test that is retained by shareholders. The abandoned plant amount includes $26.8 million of disallowance restored and is reduced by $80.2 million classified as plant in service (amortized over 17 years) and the $111 million Boardman gain. This approach also assumes the Commission would increase PGE's authorized ROE by 150 basis points, and amortizes the three regulatory assets over three years. The result of these changes is to increase PGE's total revenue requirement over the five and one-half year study period by $58.5 million,

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[7] In the "Derivation of Balance Owed PGE at 9/30/2000," each of the approaches or scenarios described in our testimony includes the revenue requirement difference (between the scenario result and actual revenue requirement per rate case results) over the five and one-half year study period, plus interest.

[8] We recognize that the Commission authorized a 37 percent overall rate increase for PGE in 2001 (*See* Docket UE 115, Order 01-777). However, that increase was caused primarily by a normalized level of power costs that was expected to persist, rather than a one-time event.

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with a resulting "Balance Owed PGE at 9/30/2000" of $274.9 million.

Staff opposes this approach because it disagrees with several assumptions in, and therefore the results of, this scenario. First, a 17-year recovery for Trojan abandoned plant with no return on investment does not seem reasonable to us, regardless of what other changes might be made in an attempt to minimize the loss of the return. Second, Staff does not agree that under the net benefit test the sharing savings that relies on recovery of the $183 million steam generator replacement costs are calculated without allowing recovery of that investment in rates. In addition, while the Commission has allowed shared savings incentive mechanisms such as SAVE (*see* PGE Exhibit 6000, Lesh/29-30), it has done so in situations where the utility has a great deal of discretion to "do the right thing." In contrast, the decision on whether or not to close Trojan was conducted in a highly visible forum and was based on clear least-cost planning principles. Third, while investors could perceive an increase in regulatory risk if the Commission set rates based on a 17-year recovery period with no return on investment, Staff has not estimated the impact on rate of return and is not persuaded by PGE's testimony that the Commission would authorize an increase of 150 basis points in PGE's return on equity. (*See* Staff/200.) Given that we do not believe this is a plausible scenario that the Commission could adopt, Staff did not rigorously analyze the potential impacts on the return required by investors.

IV. Staff's Alternative Approach

Staff also prepared an alternative scenario that allows a one-year recovery of net Trojan investment, assuming that the Commission might have been willing to allow a significant rate increase and limit the number of unusual ratemaking adjustments. This scenario uses the same building blocks as PGE's Approach II with Staff's modifications, except that there is no deferral and subsequent amortization of first year power costs.

The Commission might take such an approach if it decided a short-term increase in power costs was preferable to deferring a significant portion of ongoing power costs. Staff estimates this approach would result in a one-year incremental rate increase of approximately 12 percent,

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which we believe is a plausible outcome.

This scenario results in a $17.0 million higher revenue requirement over the study period, but the balance owed PGE on September 30, 2000, is the same as Staff's modified Approach II: $158.9 million. (*See* Staff/102, Busch-Johnson/3.)

V. URP's Approach

The Utility Report Project (URP) calculates a refund amount of $806 million due ratepayers 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. URP witness Lazar states that: "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." (*See* URP/200, Lazar 13, 16 and 202/1.)

Staff believes the Commission should disregard URP's calculation regarding how much PGE may have over-recovered Trojan investment, because it does not address 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." URP's approach is inconsistent with the ratemaking scope the Commission identified for the first phase of these proceedings; therefore, Staff did not attempt to evaluate the calculations and assumptions underlying URP's approach.

URP also proposes an adjustment to PGE's rates based on a change to the authorized capital structure—a reduction to the equity in PGE's rate base—that URP claims would have occurred if Trojan had been immediately written off. Staff disagrees that a reduced percentage of equity as described by URP would have resulted in a lower overall rate of return. URP's positions are not consistent with the use of a hypothetical capital structure, use of 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. (*See* Staff/400, Conway/2-5.)

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VI. Other Issues

A. PGE's use of five and one-half year study period

Staff believes that the use of a revenue requirement differential over the five and one-half year study period with associated interest in the calculation of the balance owed for the various scenarios is reasonable. The purpose of the analysis is not to restate PGE's actual balance sheet. Rather, this analysis is intended to assess whether PGE's rates over the five and one-half year period and the UM 989 rates were just and reasonable. To do so, it is necessary to compare what PGE would have collected over the five and one-half year period to its actual revenue requirement during that period. For that reason, it makes sense that if the Commission determines a revenue requirement that concludes PGE should have collected more dollars than it actually did over the five and one-half year period, that that difference should be recognized along with the associated time value of money.

Moreover, this assumption provides symmetry. If the scenario the Commission adopts results in the finding that PGE was not owed at least $180.5 million (or at least $164.1 million) at September 30, 2005, the effective date of the UM 989 offset decision, it is possible PGE will owe refunds to customers. Logically, the refund would be based on the amount that customers overpaid during the five and one-half year period, including the time value of money. The effect of the revenue requirement difference over the 5.5 years must be included in the calculation of the "Balance Owed PGE at 9/30/2000" to accurately measure how much customers underpaid or overpaid as of that date.

B. Implications for PGE's current accounts or rate base if the Commission concludes that PGE does not owe refunds.

If the Commission were to conclude that PGE did not owe refunds, it would mean that the implied regulatory asset owed PGE on September 30, 2000, was at least $180.5 million, the amount against which $161 million in customer credits was used in UM 989 as an offset. Conceptually, it could be argued that if the Commission found PGE were owed more than the

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actual remaining Trojan investment on September 30, 2000, customers would still owe that amount (plus interest).

In response to Staff requests 47 and 48, PGE stated: "[I]f the Commission decision in this proceeding resulted in customers owing PGE more than $180.5 million at 9/30/2000, PGE would not propose to recover the incremental amount from customers" or "propose to re-state its accounts or rate base going forward to reflect any change in the elements included in that scenario." PGE noted that such a Commission decision would mean that the benefits received by customers in UM 989 exceeded the original estimate of benefits since customers would have offset a larger receivable with the same credits. Staff agrees with PGE that if the Commission makes that finding, there should be no effect on customer rates going forward, given its understanding that PGE is not requesting any revenues.

C. Debt Costs for Trojan Investment

In PGE's Opening Brief at 17-18 and Exhibit/6000 at 37-38, the company discusses whether, with respect to interpreting ORS 757.355, the Commission could allow recovery of debt and interest payments related to Trojan investment. PGE states that other jurisdictions have differentiated between debt related to uncompleted generating plant and potential equity return. However, none of PGE's three approaches propose recovery of debt payments. Likewise, as explained in Staff/200, we do not recommend the Commission consider that as a possible ratemaking element in this case. Staff does not agree with PGE assertion that the Court of Appeal's decision in *Citizens Utility Board, et al v. PUC*, 154 Or App 702, 707 (1998), does not prohibit a return on debt. The Court there observed that the issue presented was "whether PGE's rates may include the rate or 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 the Court of Appeals concluded that the Commission could not authorize PGE to earn a return on its undepreciated investment in Trojan, the court was referring to *any* return on Trojan

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investment, whether it was classified as debt or equity. (*See* Staff/100, Busch-Johnson/25; Staff/200, Morgan/4; Staff/300, Busch-Johnson/5; URP/400, Meek/8.)

SUMMARY

In sum, Staff believes that previous Commission decisions indicate that retired Trojan plant should be included in rates in a manner that provides PGE recovery of essentially all of the present value of the investment. There are two scenarios with ratemaking elements we believe represent what the Commission reasonably would have done in UE 88 had it known it is unlawful to allow PGE to earn a return on retired plant. These scenarios meet the objectives of intergenerational equity, rate stability, and maintaining PGE's financial integrity. If the Commission concludes that it would have set UE 88 rates to minimize additional rate fluctuations related to Trojan recovery, we recommend the Commission endorse PGE's Approach II with Staff's modifications. Alternatively, if the Commission concludes that it would have set rates that allowed a moderate incremental rate impact with as few changes as possible to non-Trojan rate elements, we recommend the Commission accept Staff's alternate approach. The result in both scenarios would be the same, with $158.9 million owed PGE and available for the UM 989 offset on September 30, 2000.

DATED this 9th day of November 2005.

Respectfully submitted,

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CERTIFICATE OF SERVICE

I hereby certify that on the 9th day of November 2005, I served the foregoing document upon the parties hereto by the methods indicated below:

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