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)	**PORTLAND GENERAL ELECTRIC COMPANY'S OPENING POST HEARING BRIEF (PHASE I)**

I. INTRODUCTION

Portland General Electric Company ("PGE") submits this Opening Brief to describe the issues that the Commission must decide in Phase I of this proceeding and to summarize PGE's recommendations.

II. LEGAL STANDARD

This is a remand proceeding in which the Commission must exercise its rate-making authority. To decide what rates should be today (*i.e.*, whether there is any basis for a refund), the Commission must decide what rates it would have established in UE 88 had it known that ORS 757.355 prohibited a "return on" Trojan. As in any rate-making proceeding, the Commission must fulfill its obligations under its general grant of authority to further the interests of utility customers and shareholders (ORS 756.040), while establishing rates that are "just and reasonable" under its specific rate-making power (ORS 757.210 and ORS 757.020).

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

III. SCOPE OF PROCEEDING

The scope of this proceeding has already been the subject of extensive comments and Commission rulings and orders. An ALJ ruling, a Commission Order affirming the ALJ Ruling, and another Commission order rejecting URP's application for reconsideration have all described the task before the Commission and the parties. ALJ Ruling dated August 31, 2004 ("ALJ Ruling"); Commission Order No. 04-597 ("Scope Order"); Commission Order No. 05-091. The work of this phase is:

> To undertake 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.

From this simple statement flow several important implications. First, it requires the Commission to engage in ratemaking under the Commission's broad authority to set just and reasonable rates. Commission Order No. 04-597 at 6 ("We also agree with the ruling 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."). The Commission has its broadest degree of discretion when acting in its legislative rate-making role, a principle the Oregon courts have embraced repeatedly: "ratemaking is a purely legislative function, involving broad discretion in selecting policies and methods." *American Can Co. v. Lobdell*, 55 Or App 451, 463, 638 P2d 1152 (1982). As long as the Commission acts within constitutional and legislative restraints, it is not "obligated to employ any single formula or combination of formulas to determine what are in each case 'just and reasonable rates.'" *Pacific Northwest Bell Telephone Co. v. Sabin*, 21 Or App 200, 224, 534 P2d 984 (1975).

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Second, the Commission and parties are not confined to a single rate-making component or issue. Rather, the Commission must consider all relevant aspects of the utility's circumstances to determine a revenue requirement that furthers the interests of utility shareholders and customers and provides the basis for just and reasonable rates. Anything less would constitute "single-issue ratemaking, which is prohibited." Order No. 04-597 at 6. In deciding upon the scope of this proceeding, the Commission has broad discretion. It is for the Commission to determine what additional evidence to receive and what findings to make in this remand proceeding. *Pacific Tel. & Tel. Co. v. Hill*, 229 Or 437, 486, 367 P2d 790 (1962).

Third, the Commission need not duplicate every aspect of the UE 88 general rate case. This proceeding is limited to those "aspects of the ratemaking process in UE 88 that are affected by the Court of Appeals' statutory interpretation of ORS 757.355." Order No. 04-597 at 6. The Commission's Scope Order identified three such issues—the appropriate recovery period for the Trojan investment balance, the cost of capital, and the application of the net benefits test—but the Commission invited the parties to raise any other rate-making issues consistent with the "general framework of the scope for the first phase." *Id.* at 7.

The Commission's task in this phase, as set forth in the Scope Order, is consistent with the remand orders in DR 10, UE 88 and UM 989. In the DR 10 and UE 88 dockets, the Court of Appeals identified the "principal if not only issue before" it was "whether PGE's rates may include the rate of return component or are instead limited to recovery of the declining principal amount of the undepreciated Trojan investment." *Citizens' Utility Board*, 154 Or App at 706-07. The Court of Appeals concluded that ORS 757.355 limited the Commission's authority and prevented it from approving rates that included a rate of return component for facilities that were not in service. As the

Commission concluded in the Scope Order, "the orders in DR 10 and UE 88 were reversed solely on the grounds that the Commission had exceeded its legislative authority." Order No. 04-597, Appendix A at 15. The Court of Appeals made no determination, and provided no guidance, regarding whether the end rates established in UE 88 were just and reasonable.

The Circuit Court remand of the UM 989 final order is also instructive. The Circuit Court faulted the Commission for considering only the prospective treatment of Trojan while ignoring amounts collected from customers in the period preceding UM 989. The ALJ's ruling covering scope, which the Commission affirmed and adopted in Order No. 04-597, observed:

> To approve end rates within this scope, however, the Commission would have had to conduct far different proceedings than those actually conducted in UM 989. In reviewing the settlement, the Commission needed to address the following question: What rates would have been approved in UE 88 if the Commission had interpreted the authority delegated to it in ORS 757.355 as the Court of Appeals did in the Citizens' Utility Board?

ALJ Ruling at 15.

The Circuit Court anticipated that the Commission would engage in just such a rate-making analysis in this remand proceeding:

> At the Commission you [PGE] can argue . . . if you can't give us [a return on the Trojan investment], you have to give us something else, because otherwise we aren't made whole . . . And that's probably what you're going to do . . . And that may or may not result in any net rate relief.
>
> I'm not prepared to buy off on that today, but I am certainly not prepared to conclude that you can't argue on remand to the PUC that if you can't get a return on your investment, they need to put something else in your [rate] base for some other reason that . . . allows you to have . . . a rate of return that's economically viable for you to continue on as a successful utility company.

July 23, 2003 Hearing Tr. at 177, 179 (quoted in Scope Order at 6).

The Commission sets rates using a two-step process. First it establishes a revenue requirement figure. Second, it allocates that revenue requirement among ratepayers. There are no rate spread issues in this docket. The focus of the evidence PGE presents is determining what the revenue requirement would have been in UE 88 and tracking the rate-making and accounting impacts that follow. Future phases of this remand proceeding will address reconciling the results of Phase I with actual rates, the Commission's legal authority to issue refunds (if earlier phases support refunds), and administration of any refunds. ALJ Ruling at 19.

IV. PGE'S RECOMMENDATIONS

A. PGE'S RECOMMENDED FRAMEWORK

In UE 88, the Commission considered a number of issues, such as the recovery period for PGE's investment in Trojan, a return on the remaining Trojan balance, characterization of the remaining investment in Trojan, the net benefits test, and potential offsets. The Commission did not make decisions with respect to each of these issues in isolation. Rather, the Commission attempted to resolve them to create rates that achieved (1) its overarching goals of safe and adequate utility service for customers over time at reasonable rates and (2) its objectives of ensuring utilities such as PGE continued to make resource decisions that provided net benefits to customers while achieving relative stability and intergenerational equity in rates. In other words, there was no single "right" answer to many important questions in UE 88, such as over how long PGE should recover the undepreciated Trojan investment or whether the Trojan balance should be offset against available customer credits. The Commission could have used different combinations of decisions to achieve its rate-making goals.

Now the Commission must revisit the rates it set in UE 88 and determine how it would have set rates if it could not use one of the tools it relied on then—allowing a return

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

on PGE's remaining undepreciated investment in Trojan. The Commission would have had to resolve the other issues, or building blocks, in a different way.

There are several principles that should guide the Commission in making decisions that serve its overarching goals in this remand proceeding. Some flow from the legal rulings in this docket, others reflect general Commission policies. With respect to legal decisions in this docket, the Court of Appeals decided both (1) that rates may not include a return on retired plant, and (2) that PGE is entitled to recover the undepreciated investment in Trojan. 154 Or App at 714. URP argued in the appeal of Order No. 95-322 that the utility statutes barred PGE from recovering first a "return on" and second a "return of" its investment balance in the Trojan facility. The Court of Appeals accepted the first but rejected the second argument, concluding that PGE should be permitted to recover its principal investment. *Id.* In this docket, PGE and Staff both have recommended combinations of rate-making tools that satisfy the Court of Appeals' twin requirements.

In addition to these legal rulings, traditional rate-making policies guide the Commission. At the core, the Commission's decisions must serve both customers' interests in adequate, safe service at fair, reasonable rates and shareholders' interests in earnings that are commensurate with the returns on investment in comparable businesses and the need to preserve the utility's financial integrity, maintenance of credit, and attraction of capital. (PGE/6000, Lesh/7.)

To implement this first principle of ratemaking and establish the rates customers pay, the Commission utilizes a variety of regulatory frameworks and conventions. Regulatory frameworks are paradigms the Commission uses, such as integrated resource or least cost planning, that guide but do not necessarily determine a particular rate-making outcome. *Id.* Conventions are practices the Commission normally applies, such as cost of service or the choice of a test year, unless there is a good reason to depart from the customary

practice. *Id.* In this docket, the Commission must replace the convention it adopted in DR 10, according to which PGE could recover its Trojan investment through 2011 while earning a return on the investment.

PGE recommends that the Commission consider three criteria when crafting an alternative rate-making convention in this docket: First, the decision should encourage electric utilities to analyze and make resource decisions that will:

> yield an adequate and reliable supply of energy at the least cost to the utility and its customers consistent with the long-run public interest.

(PGE/6000, Lesh/14-15.) Put simply, the decision should further the Commission's least-cost planning principles. Second, the decision should equitably allocate the costs and benefits of utility resource decisions over time, answering the question:

> Does this decision equitably allocate the costs and benefits of utility resource decisions to customers over time, such that no one 'generation' of customers bears an inequitable burden of the costs or receives an inequitable share of the benefits?

Id. Third, the decision should preserve the utility's financial integrity and ability to attract debt and equity capital, answering the question:

> Does this decision preserve the utility's financial integrity and ability to attract debt and equity capital so that the adequacy and cost of service to future customers is not compromised?

Id.

Using these criteria, PGE recommends that the Commission identify a range of possible outcomes for UE 88 rates. (PGE/6800, Lesh/3.) Unlike a general rate case, in this remand proceeding the Commission need not establish a single UE 88 revenue requirement. The evidence in this docket supports a range of reasonable alternative UE 88 rates. The Commission need not choose from among these alternatives because they all demonstrate the same thing. They all show that UE 88 rates were just and reasonable, and they all leave PGE's balance sheet in roughly the same position at the time of the UM 989

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settlement. (PGE/6800, Lesh-Hager/3 ("As a policy matter, PGE believes that the Commission can and should evaluate the reasonableness of the UM 989 settlement using a range of possible outcomes for the UE 88 remand.")) Accordingly, there is no need for the Commission to choose among the available alternatives that are within the range of reasonableness.

B. RECOMMENDED RATE-MAKING TOOLS AND FINANCIAL IMPACTS

1. Rate-making Tools

Based on the above requirements and considerations, PGE recommends that the Commission find that PGE's UE 88 revenue requirement would have been set to:

1. Recover the entire undepreciated investment in Trojan in one year, based on (a) the positive net benefit resulting from comparing the cost of closure to the cost of continued operation[1] and (b) including the effects of the Court of Appeals' interpretation in the cost of closure and steam generator replacement in the cost of continued operation;
2. Leave $80 million of the Trojan assets in the plant-in-service accounts;
3. Offset the $111 million Boardman gain against the undepreciated Trojan assets that were not still plant-in-service and amortize the remainder over one year;
4. Authorize return on equity of 11.85 percent, a twenty-five (25) basis point increase over the return on equity used in UE 88;
5. Defer a portion of its 1995 and 1996 net variable power costs, for recovery over the subsequent 10 years; and
6. Recover the AMAX termination payment, pre-UE 88 deferred power costs and SAVE incentive over the same 10 years.

The above set of building blocks is PGE's preferred alternative. Nevertheless, there are other reasonable options that PGE supports, one of which Commission Staff

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[1] The costs compared are the total costs and total impact on customers of each alternative. The cost of closure includes recovery of Trojan's undepreciated balance plus the projected cost of replacement power resources. The cost of continued operation includes a return of and a return on Trojan's asset balance as a power plant operated for the benefit of customers.

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proposed. This proposal uses a modified set of building blocks. The principal changes Staff makes to PGE's recommendation are to do away with the rate-smoothing use of power cost deferrals for 1995 and 1996 (No. 5 above), eliminate the 25 basis point increase in allowed return on equity (No. 4 above), and reduce recovery of the original net benefits test disallowance to $17.7 million instead of eliminating the entire $26.8 million disallowance (No. 1 above). (Staff 100/Busch-Johnson/22-23.) Although PGE generally supports Staff's approach as a reasonable alternative (PGE/6800, Lesh-Hager/4), PGE maintains that (1) the evidence supports a 25-basis point increase in the authorized return on equity and (2) the entire net benefits' disallowance should be restored because of the steam generator replacement costs that would have been incurred under the "no-closure" scenario. (*Id.* at 4-6.)

PGE also supports a 17-year recovery period alternative. This option includes the following building blocks:

1. Recover the entire undepreciated investment in Trojan over 17 years, based on (a) the positive net benefit resulting from comparing the cost of closure to the cost of continued operation and (b) including the effects of the Court of Appeals' interpretation in the cost of closure and steam generator replacement in the cost of continued operation;

2. Receive 20 percent of the positive net benefit created through its economic retirement of Trojan, spread evenly over 17 years;

3. Leave $80 million of the Trojan assets in the plant-in-service accounts;

4. Offset the $111 million Boardman gain against the undepreciated Trojan assets that were not still plant-in-service;

5. Be allowed a required return on equity of 13.1 percent; and

6. Recover the AMAX termination payment, pre-UE 88 deferred power costs and SAVE incentive over three years beginning with UE 88 rates. (PGE/6000, Lesh/43-44.)

Although this alternative is reasonable, PGE's proposed one-year recovery approach is preferable. A 17-year recovery period would have resulted in a significant initial

write-off of PGE's undepreciated investment in Trojan that is difficult to reconcile with least-cost planning and IRP principles and could jeopardize the financial integrity of the utility. As Ms. Lesh testified:

> This scenario makes it harder to answer the question [least-cost planning criteria] positively because, regardless of some of the positive regulatory policies assumed in this scenario, the results in 1995 would have been a $71 million write-off for PGE. The opportunity to earn on equity adjusted for the increased risk investors faced and the share-the-savings payment would have increased the return investors had an opportunity to earn but such results would have come only over time and subject to the outcome of other risks PGE faced.

(PGE/6000, Lesh/44.)

2. Financial Impacts

In addition to finding that the above proposals establish a reasonable range of rates for UE 88, we also recommend that the Commission conclude in this phase that adoption of these building blocks would have the following financial impacts:

First, using either of PGE's two approaches or Staff's alternative building blocks, the UE 88 revenue requirement would have been higher than the actual UE 88 revenue requirement determined in 1995. (PGE/6200, Tinker-Schue-Hager/30-34; Staff/102, Busch-Johnson/3 (column A, row 15).) PGE's one-year recovery recommendation results in a UE 88 revenue requirement that is $6.5 million higher; Staff's alternative is at least $75 million higher[2]; and PGE's 17-year recovery period alternative is $63,000 higher.[3] This financial impact is important. It demonstrates that UE 88 rates were just and reasonable because they were lower than the rates the Commission otherwise would have established.

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[2] We say "at least" because Staff's figure does not include the 25 basis point increase in authorized return on equity and reversal of the entire net benefits disallowance, both of which PGE recommends.

[3] For PGE's figures, *see* PGE/6200, Tinker-Schue-Hager/30-34. For Staff's figure, see Staff/102, Busch-Johnson/3 (column A, row 15).

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888 SW Fifth Avenue, Suite 1600
Portland, Oregon 97204
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Second, under the PGE one-year recovery approach, at the time of the UM 989 settlement, customers would have owed PGE approximately $198 million instead of the $180 million Trojan balance that was used to offset about $161 million in customer credits. (PGE/6200, Tinker-Schue-Hager/30.) Under Staff's alternative, customers would owe at least $158.9 million at the time of the UM 989 settlement.[4] (Staff/102, Busch-Johnson/3.) PGE's 17-year recovery alternative yields a customer debt of about $275 million at the time of the UM 989 settlement. (PGE/6200, Tinker-Schue-Hager/34.) While the UM 989 settlement will be examined in more detail in a later phase in this proceeding, these financial impacts show that the range of reasonable UE 88 rates place PGE's balance sheet in roughly the same posture as of the date of the order approving the UM 989 settlement and suggests that customers received substantial economic benefit from the UM 989 settlement.

V. BUILDING BLOCKS

In its testimony, PGE analyzed various building blocks the Commission should consider and suggested how the Commission might have rebalanced them in order to allow PGE a full return of its prudent investment in Trojan while maintaining stable and equitable rates for customers. The following subsections discuss each of the building blocks.

A. RECOVERY PERIOD

In light of the Commission's decision that PGE was entitled to a return of the full amount of its prudent investment in Trojan, which the Court of Appeals affirmed, the Commission should have allowed PGE to recover its investment in as short a period as was feasible. The 17-year recovery period decided upon by the Commission in UE 88 was fair only because PGE was allowed a return to compensate for the delayed recovery of its funds. By "fair" in this context, we mean achieving the overarching goal of setting rates that further

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[4] Again we say "at least" because Staff's figure does not include the 25-basis point increase in authorized return on equity and reversal of the entire net benefits disallowance, both of which PGE recommends. *See* pages 8-9 above.

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888 SW Fifth Avenue, Suite 1600
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503-221-1440

the goals of safe, reliable utility service to customers, preserving the financial integrity of the utility, and ensuring that utilities continue to make resource decisions that benefit customers and achieve intergenerational equity among customers. (*See* PGE/6000, Lesh/14-15.)

Leaving the recovery period at 17 years without a return would be equivalent to an initial disallowance of $182 million (PGE/6000, Lesh/20; PGE/6200, Tinker-Schue-Hager/16), which would be contrary to the Commission's purpose of allowing PGE to recover the full amount of its prudent investment and the Court of Appeals' twin requirements—(1) PGE should be permitted to recover the undepreciated investment balance of Trojan; and (2) there should be no return on component for retired plant. Moreover, a 17-year recovery period is inconsistent with the objective of ensuring that utilities continue to make least-cost resource decisions. Spreading recovery over 17 years would have resulted in an immediate write down of PGE's undepreciated investment in Trojan without any finding of imprudence or violation of least-cost planning principles to support it. (PGE/6000, Lesh/44.) Unless the Commission can allow PGE the time value of amounts received over time, spreading recovery over time will result in rates that do not meet the objectives the Commission must meet with respect to investors or least cost principles, even if such spreading may meet the objectives of intergenerational equity and rate stability. *Id.*

The Court of Appeals expressly declined to address whether PGE could recover its remaining investment in Trojan immediately rather than over time. *CUB*, 154 Or App at 712 n.5. The Commission noted in UM 989 that it has the authority to prescribe the accounting treatment for public utilities, including the authority to prescribe amortization periods for assets, pursuant to ORS 757.105 to ORS 757.140. UM 989, Order No. 02-227 (March 25, 2003), at 12-13. Thus, the Commission concluded in UM 989 that it "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 . . ." *Id.* at 10-11.

Therefore, PGE recommends, and Staff agrees, that the Commission should have granted PGE recovery of its remaining investment in Trojan expeditiously so as to minimize erosion of the value of PGE's investment and further least-cost planning principles. (PGE/6000, Lesh/20-22; Staff/100, Busch-Johnson/6-8; PGE/6800, Lesh-Hager/2.) As Staff testified:

> We expect the Commission, in revisiting its UE 88 decision, would have allowed 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.

(Staff/100, Busch-Johnson/8.) A longer recovery period would impose a substantial disallowance. Disallowances may be warranted where the Commission finds imprudence, but disallowances are not appropriate if a plant was retired because it was no longer economic to operate.

The period of recovery that both PGE and Staff propose is one year. However, even a delay of one year would reduce the present value of PGE's investment. Accordingly, the Commission should recognize this delay as a benefit to customers when it reconsiders the net benefits test for the closure of Trojan.

B. NET BENEFITS TEST

The Court of Appeals' decision that the Commission may not allow any return on PGE's investment in Trojan alters the Commission's net benefits analysis of whether customers benefit from closing Trojan. Customers enjoy a net benefit in the closure scenario that increases with every year that PGE's return of its investment is deferred. PGE recommends that the Commission recalculate the net benefits test in UE 88, taking these cost savings into account:

> Whether amortization of the undepreciated balance is over one year or 17 years, excluding any return on investment effectively reduces the cost to customers and thus increases the benefit of closure. All else being equal, this will lower the cost

> of the replacement resources side of the net benefits test, increasing the net benefits to closure. The PGE panel calculates that adjusting the net benefits test for the Court of Appeals' interpretation results in a net benefit for closure of negative $4 million, assuming a one-year amortization period, and $155 million, assuming a 17-year amortization period. This adjustment is consistent with and required by the Commission's methodology.

(PGE/6000, Lesh/26.)

The Commission disallowed recovery of $26.8 million (before taxes) on the basis of the test in UE 88. (PGE/6200, Tinker-Schue-Hager/14.) The value to customers of a one-year delay in PGE's recovery of its Trojan investment is $23 million. (PGE/6200, Tinker-Schue-Hager/16.) This amount will be less if the Commission treats some of the Trojan balance as plant-in-service rather than as abandoned. If the Commission decides that $80 million of Trojan remained as plant-in-service, then the value to customers of a one-year delay in recovery of the remainder of PGE's investment in Trojan is $17.66 million. (Staff/100, Busch-Johnson/19 ("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 a one-year period"). PGE recommends, and Staff agrees, that the Commission should reverse part of its initial disallowance in UE 88 accordingly.

PGE also recommends that the Commission reconsider its determination to exclude all of PGE's projected cost of replacing Trojan's steam generators from the total cost of continued operation for purposes of the net benefits test. (PGE/6000, Lesh/26-28; PGE/6800, Lesh-Hager/5-6.) The Commission found that PGE acted prudently with respect to the purchase and maintenance of the steam generators. Order No. 95-322, at 3. Ordinarily, the Commission allows utilities to recover their prudently-incurred costs. The Commission's decision to exclude the *entire* cost of replacing Trojan's steam generators from PGE's cost of continued operation was an exceptional exercise of the Commission's

discretion. It was not the only "right" way to resolve this issue. The Commission made this decision in the context of the UE 88 rate-making proceeding as a whole, and the Commission is free to reconsider its decision in light of its rebalancing of the relevant factors in this proceeding to achieve an overall fair result. As Ms. Lesh testified:

> We suggest here that, had the Commission known that the Court of Appeals would interpret ORS 757.355 to prohibit rates that included a return on the remaining Trojan investment, the Commission might not have exercised its discretion on this issue as it did. It might not have found it "fair" to allocate this cost to shareholders. No convention dictated the original result and none inhibits a different decision now. Indeed, good regulatory policy supports reversing this UE 88 decision.

(PGE/6000, Lesh/27.)

While Staff does not concur with PGE's proposal regarding steam generators, Staff does acknowledge that the Commission has authority to exercise its discretion with respect to this factor differently than it did before. (Staff/300, Busch-Johnson/4.)[5] The Commission must reconsider all aspects of its ratemaking in UE 88 that are affected by the Court of Appeals' statutory interpretation. (Scope Order at 5.) Because the Commission must revisit its net benefits analysis for the closing of Trojan to take into account the effect of the Court of Appeals' ruling, the Commission should assure itself that its net benefits analysis as a whole is fair and results in fair rates. The Commission may determine that it would not be fair to disallow the entire cost of replacing the steam generators, without any finding of imprudence, particularly if the Commission must delay PGE's recovery of its prudent investment in Trojan. Staff expresses concern that the Commission's reconsideration of its decision regarding the steam generators might "circumvent ORS 757.355." (Staff/300, Busch-Johnson/4.) This concern is unwarranted. ORS 757.355 does not control the

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[5] Staff initially disagreed with PGE's proposal with respect to the steam generator costs, in part because Staff believed that PGE made no efforts to pursue remedies against Westinghouse for the faulty generators (Staff/100, Busch-Johnson/20), which was not correct (PGE/6800, Lesh-Hager/6).

Commission's determination of what costs it would have allowed PGE to recover had Trojan remained in operation. ORS 757.355 applies only to plant that is not in-service, which by definition is not the case under the "continued operation" scenario and the net benefits test.

PGE suggests that the Commission find that it is fair to include all, or at least part, of the prudent cost of replacing Trojan's steam generators in the cost of continued operation of Trojan for purposes of the net benefits test. Including the entire prudent cost increases the benefits of closure by $183 million, resulting in a large positive net benefit (assuming a one-year recovery period). (PGE/6200, Tinker-Schue-Hager/16-17.) This results in a substantial benefit to customers from the shutdown of Trojan and justifies reversal of the entire $26.8 million disallowed in UE 88 on the basis of the net benefits test. (PGE/6000, Lesh/29-31.) [6] Including even a small fraction of the prudent costs for the steam generators would still result in a positive net benefit and justify reversal of the disallowance.

C. PLANT-IN-SERVICE

In its original decision in UE 88, the Commission determined that the accounting classification of Trojan assets to be used for safety, environmental protection and decommissioning would have no effect on rates, and for that reason the Commission classified these assets as abandoned rather than as plant-in-service. Order No. 95-322, at 53. The Court of Appeals' decision undermines the basis for the Commission's resolution of this issue, and therefore the Commission should reconsider the proper accounting classification of Trojan assets. As Ms. Lesh recommended:

> The Commission should revisit its decision regarding the classification of Trojan assets betweens plant-in service and unrecovered plant because, as with its decision regarding amortization period for undepreciated Trojan investment, it relied on the assumption that it could allow PGE to recover its

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[6] PGE also recommends that the Commission consider allowing PGE to share 20 percent of the savings, especially if the recovery period for Trojan were to remain 17 years. (PGE/6000, Lesh/29-31; PGE/6200, Tinker-Schue-Hager/19-20.)

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

> cost of capital regardless in which account PGE recorded the assets. In other words, as the law stood when the Commission made this decision in UE 88, the decision made no practical difference.

(PGE/6000, Lesh/31.)

PGE recommends, and Staff agrees, that the Commission should find that $80 million in undepreciated Trojan investment remained in utility service following the closure decision. (PGE/6000, Lesh/31-32; PGE/6200, Tinker-Schue-Hager/22; PGE/6300, Quennoz-Peterson-Dahlgren/1-8; Staff/100, Busch-Johnson/16-17; PGE/6800, Lesh-Hager/21-22.) [7] As the PGE Panel of Quennoz-Peterson-Dahlgren testified:

> Q. Was Trojan abandoned in 1995?
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> A. No. The plant was far from abandoned in 1995 because it was in the early stages of a long and complicated decommissioning process. Further, neither Staff nor the Commission explicitly disagreed with PGE's method to identify Trojan plant in service. In fact, Staff audited PGE's analysis and work papers and their testimony took no exception to our results. Ultimately, the Commission agreed that the referenced assets were providing service (OPUC Order No. 95-322, p. 53).
>
> Q. Are these assets necessary to protect the public health and safety?
>
> A. Yes. These assets provide necessary service, required both before the Trojan plant was shut down and during the commissioning.

(PGE/6300, Quennoz-Peterson-Dahlgren/5.) Staff witnesses agreed:

> We agree with classification of $80.2 million of Trojan investment as plant in service . . . There are several reasons that support classification of a portion of Trojan investment as plant in service. 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

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[7] The $80 million figure is a net number. The gross figure is $130 million. (PGE/6300, Quennoz-Peterson-Dahlgren/6.)

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> 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.

(Staff/100, Busch-Johnson/16.)

URP argues that protection of public safety during decommissioning is not a "utility service" (URP/204, Meek/15-16), but that argument reflects an unduly limited interpretation of the services a utility should provide to the public. ORS 757.355 permits the Commission to include in rate base property "presently used for providing utility service to the customer." In *CUB*, the Court of Appeals found that this statute expresses a traditional rate-making principle and does not impose a new form of restraint. 154 Or App at 710. The definition of "service" is found in ORS 756.010(8): "'Service is used in its broadest and most inclusive sense and includes equipment and facilities related to providing the service or the product served." In PGE's Opening Brief, we cited decisions in Oregon and other states illustrating how broadly utility "service" is interpreted. (PGE's Opening Brief at 13-14.)[8] Consistent with that broad interpretation, the Commission should reconsider its classification of Trojan assets in UE 88 and find that $80 million of assets remained in service for safety, environmental protection and decommissioning.

In 1994, PGE presented evidence to support inclusion of $80 million of Trojan assets in plant-in-service.[9] (PGE/2000, Marold/69-71.) FERC approved PGE's

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[8] *Northwest Climate Conditioning Ass'n v. Lobdell*, 79 Or App 560, 565 (1986); *In re Pacific Northwest Bell Tel. Co.*, 110 PUR 4th 132, 1989 WL 418536 (OPUC Dec. 29, 1989); *Bookstaber v. PECO Energy Co.*, 2004 WL 2983032 (Pa. PUC Nov. 23, 2004); *In Re Gulf Power Co.*, 218 PUR 4th 205, 2002 WL 1349501 (Fla. PSC June 10, 2002); *West Penn Power Co. v. Pa. PUC*, 578 A2d 75, 76 (Pa. Commw. Ct. 1990).

[9] PGE's analysis of its actual use of Trojan assets following UE 88 would support the inclusion of $113.6 million of Trojan assets in plant-in-service. (PGE/6300, Quennoz-Peterson-Dahlgren/6-7; PGE/6303, Quennoz-Peterson-Dahlgren/1-18.) However, PGE's evidence in UE 88 supported the $80 million figure, and PGE does not request that the Commission approve a higher amount.

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classification of those assets within Account 101, Plant-in-service. (PGE/6301, Quennoz-Peterson-Dahlgren/1-9.) Neither Staff nor the Commission disagreed with PGE's methodology, and in fact the Commission acknowledged that the assets "provide the service necessary for safety and asset preservation pending decommissioning and dismantling of the plant." Order No. 95-322 at 53. Thus the Commission implicitly recognized that these assets were not in fact abandoned. PGE requests that, in light of the Court of Appeals' decision that "abandoned" assets may not be included in rate base and earn a return, the Commission reconsider its classification of Trojan assets that remained in use to serve the public interest and allow $80 million of assets to remain in the plant-in-service category.

D. BALANCE SHEET OPTIONS

PGE's balance sheet at the time of UE 88 included a customer credit of $111 million from the sale of a portion of Boardman, which was being amortized over a 27-year period ending in 2013. PGE recommends that the Commission conclude that it would have offset the remaining Boardman credit against an equal amount of undepreciated Trojan investment, and Staff agrees with this proposal. (PGE/6000, Lesh/33-35; PGE/6200, Tinker-Schue-Hager/23-24; Staff/100, Busch-Johnson/18.)

This offsetting of balance sheet entries would have served several beneficial purposes. First, it would have lessened PGE's loss from the delayed recovery of its prudent investment in Trojan, whether that recovery takes place over one year or over a longer period. Second, if PGE did recover its investment in Trojan over a relatively short period such as one year, the offset would have reduced the impact on customers and kept rates stable. Finally, the offset would have served the goal of intergenerational equity among customers, because both the Boardman sale and the Trojan closure affected customers over a long period, not just in the short term. Staff witnesses concur:

> It would be reasonable to reduce the remaining Trojan investment by the amount of the Boardman gain because it

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> would improve the matching of costs and benefits among generation of customers, as well 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 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.

(Staff/100, Busch-Johnson/18.)

The Commission has broad authority to prescribe accounting rules for recovery and depreciation, and the Commission exercised that authority by using the offset principle in UM 989 and UE 93 when it was in the interests of customers and the utility. See, *e.g.*, UM 989, Order No. 02-227 (March 25, 2002), at 12-13, *citing* ORS 757.105 to 140; UE 93, Order No. 95-1216 (Nov. 20, 1995), Appendix B.[10] The Commission should use the offset principle in this proceeding to facilitate PGE's recovery of its investment in Trojan in a manner that is fair to PGE and customers.

Another balance sheet option that the Commission may consider is deferring a portion of UE 88 test year power costs. (PGE/6000, Lesh/35-37; PGE/6200, Tinker-Schue-Hager/25). This deferral may be appropriate to stabilize rates if the Commission authorizes recovery of the Trojan balance in one year. ORS 757.259(2)(e) authorizes deferred accounting for "identifiable utility expenses or revenues, the recovery or refund of which the Commission finds should be deferred in order to minimize the frequency of rate changes or the fluctuation of rate levels or to match appropriately the costs borne by and benefits received by ratepayers." Because a rapid recovery of the Trojan balance would cause a significant and short-term rise in rates, the Commission may exercise its discretion to defer

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[10] Using the Boardman gain as an offset against the Trojan balance in UE 88 would have changed the options available to the Commission in UE 93. In that proceeding, the Commission decided to offset the Boardman gain against the unamortized balance of the power cost deferrals previously authorized in UM 529, UM 594 and UM 692, the AMAX deferral approved in UE 79, the SAVE incentive, and a portion of the unamortized Trojan investment. (PGE/6000, Lesh/33-35; PGE/6200, Tinker-Schue-Hager/23-24.)

some power costs in order to smooth rates. (PGE/6000, Lesh/35-36: "If the Commission decided, on remand, that PGE should amortize its Trojan investment over one year, the total revenue requirement of current power costs and Trojan recovery would be temporarily high. In these circumstances, deferring a portion of current 1995 power costs for recovery in subsequent years would simultaneously improve the matching of the costs and benefits of the Trojan closure decision and increase rate stability.")

While Staff does not include such a deferral in its proposed alternatives, Staff acknowledges that the Commission could exercise its discretion to defer power costs. (Staff/100, Busch-Johnson/18.) PGE generally supports Staff's alternative, which eliminates the 1995 and 1996 power cost deferrals as providing a reasonable alternative. (PGE/6800, Lesh-Hager/4.) PGE disagrees with certain aspects of Staff's alternative, particularly its position on the replacement steam generators, but supports Staff's overall approach.

E. RETURN ON EQUITY AND CAPITAL STRUCTURE

In 1994, PGE offered evidence that PGE's required return on equity ("ROE") was in the range of 11.46 percent to 13.37 percent, and PGE stipulated with Staff to an ROE toward the bottom of the range, at 11.6 percent, which was approved by the Commission. (PGE/6400, Hager 7-10.) The stipulation also established PGE's capital structure. *Id.* PGE's evidence on its required ROE and PGE's willingness to enter into the stipulation relied on the assumption that the Commission would allow PGE to recover its remaining investment in Trojan over time with a return. (PGE/6400, Hager/12; PGE/6800, Lesh-Hager/3-4, 9.) Now that the Court of Appeals has reversed this fundamental assumption, it is appropriate to reconsider what ROE and capital structure the Commission should have established for PGE in UE 88. As Ms. Lesh observed:

> I base this policy view on the inherently uncertain nature of determining now—over ten years later—what the Commission would have decided in UE 88. Likewise, we are hesitant now to conclude that PGE would have stipulated to the same

> revenue requirement elements to which we stipulated in UE 88. For example, PGE stipulated in UE 88 to the return on common equity of 11.6 percent. Had we known of the Court of Appeals' ruling, we might not have agreed to this number. We might have refused to stipulate for less than a higher amount, say 11.8 percent.

(PGE/6800, Lesh-Hager/3-4.)

The Court of Appeals' determination that a utility in Oregon may not earn a return on its investment in a plant that was retired from service earlier than anticipated for economic reasons sets Oregon apart from other jurisdictions. It is to be expected that investors in Oregon utilities would take this regulatory shift into account when assessing the return they expect to earn on their prudently-managed investments. (PGE/6500, Makholm/1-34; PGE/6600, Blaydon/1-15; PGE/6700, Hess/1-8; PGE/7000, Blaydon/1-8.)

> I conclude that the Court of Appeals' interpretation, disallowing any return on the undepreciated balance of a utility plant that is retired for economic reasons, increases the required rate of return that investors demand for investing in the Oregon utilities. Given the uniqueness of this new regulatory regime in the U.S., investors are likely to view Oregon utilities as above average risks relative to other utilities elsewhere in the U.S. Based on my analysis, PGE's proposed return on equity (ROE) of 13.1 percent is reasonable because it falls within the range of estimated ROEs for electric utilities with above average returns.

(PGE/6600, Blaydon/1.)

> I conclude that investors will demand a large return for Oregon utility investments because of this anomaly from the expected regulatory compact arising from this particular interpretation of Oregon law.

(PGE/6500, Makholm/3.)

PGE recommends that the Commission raise PGE's required ROE for UE 88 between 25 and 150 basis points, depending on the degree to which the Commission delays PGE's recovery of its investment in Trojan. (PGE/6000, Lesh/23-24; PGE/6400, Hager/18-25.) As an alternative, PGE recommends that the Commission use a hypothetical capital structure with greater amounts of equity to set PGE's rates, which would have the

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888 SW Fifth Avenue, Suite 1600
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same effect as the proposed change in ROE. (PGE/6000, Lesh/24-25.)

Staff agrees that, if the Commission were to delay substantially PGE's recovery of its investment in Trojan without granting any return, the Commission could compensate for the financial impact on PGE by adjusting PGE's capital structure or ROE. (Staff/100, Busch-Johnson/22; Staff/200, Morgan/25.) However, given Staff's expectation that the Commission will allow PGE to recover its investment in Trojan promptly, Staff concluded that cost of capital is not a key element of this case. (Staff/200, Morgan/24.)

PGE agrees that cost of capital is not a large factor if PGE's Trojan balance is returned within one year; however, PGE does not agree with Staff's conclusion that it is negligible. (PGE/6800, Lesh-Hager/7-10.) Staff's conclusion that there would be no cost of capital effects in the one-year scenario is based on the assumption that the one-year delay in PGE's recovery of its investment would be a "short-term, nonrecurring" event. (Staff/200, Morgan/4, 24-25.) This assumption is faulty, because the retirement of a utility asset before the end of its predicted lifespan is not a unique event but rather is one that can be expected to recur. The Commission's decision on how to permit PGE to recover its investment in Trojan signals how the Commission may deal with future plant retirements. Thus, while a one-year delay of the recovery of PGE's investment in Trojan without a return will have substantially less financial impact than a 17-year delay without a return, it nonetheless has a measurable impact, which can be expected to recur when other assets are retired. Therefore, PGE suggests that if the Commission finds that PGE should have recovered its investment in Trojan over one year, the Commission should consider a modest increase in PGE's ROE of 25 basis points.

> Whether investors in 1995 would have demanded a slightly higher return on PGE's equity would depend on whether they believed that they were adequately compensated by the Commission and what they believed the Commission would do in a similar situation in the future. Even if investors received their principal, however, they would incur reinvestment

> risk/the risk that they would not be able to invest their proceeds at the original, and higher, rate of return. Thus, rational investors would demand a slightly higher return. But, again, we note that Staff and PGE agree that the cost of capital effect would be small. Staff believes it would be 0. PGE believes it would be about 25 basis points.

(PGE/6800, Lesh-Hager/9.)

F. DEBT COSTS FOR TROJAN INVESTMENT

Another building block that PGE offers for the Commission's consideration is providing for recovery of PGE's debt costs for Trojan, while not allowing any profit to PGE's investors. (PGE/6000, Lesh/37-38; PGE/6800, Lesh-Hager/6.) PGE presents this option as an alternative to its principal proposals. Allowing for recovery of debt costs that PGE had already incurred prior to UE 88 and that PGE was obligated to repay would be consistent with the Court of Appeals' interpretation of ORS 757.355. That statute prohibits the inclusion of certain property in "rate base." In its opinion, the Court of Appeals repeatedly equated the concept of return on property in rate base with "profit." 154 Or App at 706, 713, 714. PGE does not recommend that the Commission include the Trojan balance in rate base or allow any profit on that balance. Instead, PGE suggests that the Commission may recognize the specific amounts that PGE was obligated to repay for its Trojan-related debt and include those amounts in setting PGE's revenue requirement. As discussed in PGE's Opening Brief, there is precedent for treating debt costs and profit separately for retired utility assets. (PGE's Opening Brief at 16-17.)

Staff and URP do not concur in PGE's interpretation of the Court of Appeals' decision. (Staff/100, Busch-Johnson/25; Staff/200, Morgan/4; Staff/300, Busch-Johnson/5; URP/400, Meek/8.) Staff expresses the view that neither a return on equity nor interest on debt is truly "profit." (Staff/200, Morgan/4.) But the Court of Appeals repeatedly used the term "profit" to express its understanding of what ORS 757.355 355 prohibits. Shareholders, not lenders, receive profits. The Commission has discretion consistent with the Court of

Appeals' decision to allow PGE to recover sufficient funds to meet its debt obligations for Trojan.

VI. URP'S AND CLASS ACTION PLAINTIFFS' ARGUMENTS

The bulk of the opposition argument and testimony filed on behalf of URP and the Class Action Plaintiffs (collectively, URP) is at odds with the fundamental nature of ratemaking or inappropriate for the Commission's consideration in this proceeding. URP takes the position that the Commission should eliminate the return on Trojan without giving any attention to how that change would affect the other elements that the Commission considered in its effort to set fair rates in UE 88. This approach is improper in a rate-making proceeding. URP also urges the Commission to consider events that took place after 1995 in deciding what rates it would have set in UE 88, which is improper as well.

A. ISOLATING THE RETURN ON TROJAN

URP blatantly disregards the Commission's determination that its task in this proceeding is to engage in ratemaking and determine "what rates would have been approved in UE 88" had the Commission known that it could not allow a return on PGE's undepreciated investment in Trojan if it delayed recovery. (Scope Order at 5.) Instead, URP performs a computation of a refund amount based on the rates that the Commission approved in UE 88 before it had the benefit of the Court of Appeals' ruling. (URP/200, Lazar/1-2; URP/204, Meek/1.)[11] In justification for this narrow approach, URP argues that the Commission should function in a manner identical to a trial court. (URP/204, Meek/5-8.) There are the same arguments URP made, the ALJ and Commission rejected, during the

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[11] The ALJ ruling dated September 19, 2005, declined to include Mr. Meek's testimony in the record but allowed Mr. Meek to renew these arguments in briefing and permitted the Commission to consider Mr. Meek's testimony as comments. We respond to Mr. Meek's arguments in the expectation that URP will urge them in briefs and to provide the Commission with PGE's response in the event the Commission exercises its discretion to consider Mr. Meek's testimony as comments.

scoping phase of this proceeding. (*See*, *e.g.*, Scope Order at 2-3.) The Commission's role is not as limited as URP contends.

The Commission's fundamental task in a rate-making proceeding is to establish "just and reasonable" rates pursuant to ORS 757.020. (Scope Order at 6.) In doing so, it considers and resolves various issues to reach a result that is fair to the utility and to customers. PGE's testimony describes three criteria that reflect sound regulatory policy and that may be used to guide rate-making decisions. (PGE/6000, Lesh/14.) A rate decision consists of interconnected factual and policy elements, and it is the end result, not the components, that the Commission ultimately decides is "just and reasonable." In reconsidering its decision in UE 88 to take into account the Court of Appeals' interpretation of the law, the Commission must continue to fulfill its obligations under its general powers authority (ORS 756.040) and its specific rate-making power (ORS 757.210 and ORS 757.020).

In UE 88, the Commission decided that it would be appropriate to delay PGE's recovery of its prudent investment in Trojan over 17 years while allowing PGE to earn a return on its undepreciated balance over that time. Had the Commission known that it could not allow a return on the undepreciated balance, it likely would have considered alternative approaches to achieve a fair result. Neither the Commission nor the Court of Appeals decided that it would be just and reasonable to delay PGE's recovery of its investment in Trojan over 17 years without any return.

Even if the Commission's task in this proceeding were to remove the "return on" from its UE 88 rates while holding all other elements constant, it still would be impossible to correlate the "return on" element with any amount in the actual rates charged for usage by customers. After establishing a utility's revenue requirement, the Commission engages in sophisticated processes to determine rate spread and rate design. The costs

included within revenue requirement have no direct correlation to the rates ultimately set for various types of electricity usage. Moreover, actual costs and revenues always vary from forecasted costs and revenues. (PGE/6100, Dahlgren/8-12.)

B. DEFERRED TAXES AND CAPITAL STRUCTURE

Mr. Lazar testifies that customers are entitled to the accumulated deferred taxes associated with Trojan and an adjustment to PGE's capital structure. (URP/200, Lazar/5-10.) Mr. Lazar's proposed capital structure adjustment results in a $106 million increase in URP's refund claim, and his accumulated deferred tax theory would result in a $83 million customer credit. *Id.* at 8, 9. Both theories are fundamentally flawed. They rely on the mistaken assumption that the Commission would require a complete write-off of the undepreciated investment in Trojan. This assumption is inconsistent with generally accepted accounting principles and with the Court of Appeals' decisions, which ruled that PGE could recover its investment in Trojan. As the PGE Panel testified:

> Again Mr. Lazar's error is that he assumes a full write off is required in this case. Since this assumption is not correct, his 'adjustment' to the capital structure is inappropriate. Even if the Commission had only allowed PGE to collect the outstanding balance of Trojan over a period of almost 17 years, with no return, accounting rules would not require a full write-off. The collecting of approximately $340 million over 17 years has a net present value of considerably less than $340, but much greater than zero.

(PGE/6900, Hager-Tinker-Schue/7.)

C. POST-1995 EVENTS

URP urges the Commission to consider several events that occurred after 1995 and that, therefore, the Commission could not have considered in UE 88: PGE's earnings from 1995 to 2000, Enron's purchase of PGE in 1997, and the income tax effects of Enron's ownership of PGE. (URP/204, Meek/9-14; URP/400, Meek/1.) Consideration of these post-1995 events is improper, because the Commission's task in this proceeding is to

determine "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." The new interpretation of ORS 757.355 likely would have led the Commission to consider the information available to it in 1995 differently, but the Commission could not have considered future events when setting rates in UE 88. Therefore, in determining what rates it would have set in UE 88, the Commission should disregard URP's testimony and arguments relating to post-1995 events. As the ALJ's Ruling striking portions of Mr. Meek's testimony concluded:

> Contrary to URP's assertion, this proceeding does not allow any party to present factual evidence that could not have been presented in the original proceeding. While the Commission must now apply a different legal interpretation of ORS 757.355, the factual evidence to which that statute is applied must encompass the same timeframe, that is, information that could have been presented during UE 88.

(ALJ Ruling dated July 25, 2005.)

1. Earnings

Even if it were proper for the Commission to consider post-1995 events, URP's testimony still would be irrelevant to the determination of rates in UE 88. With respect to PGE's earnings, it is inherent in utility rate regulation that actual conditions affecting costs and revenues will vary from the test year conditions on which rates are based, and neither the utility nor its customers can recover for these fluctuations. (PGE/6800, Lesh-Hager/12, 17.) While PGE's earnings may have been higher than expected for a few years following UE 88, PGE's earnings were lower than expected in subsequent years. (PGE/6800, Lesh-Hager/12.)

> The Commission sets rates so that a utility has an opportunity "on average" to earn its authorized return on equity. Sometimes the utility earns more than its expected return on equity; sometimes it earns less. Earnings in any particular year depend on many factors, particularly hydro conditions and market gas and electric prices. In fact, some of these and other

> factors combine so that PGE earned less than its authorized return on equity in the years 1999 through 2003.

(PGE/6800, Lesh-Hager/12.)

2. Enron Acquisition

As for Enron's acquisition of PGE, the price paid by Enron to Portland General Corporation's ("PGC") stockholders does not bear on any issue relevant to a rate-making proceeding. Gains and losses on stock sales are not recognized in ratemaking, nor are changes in the market value of assets.

> Gains or losses on stock sales are not recognized in ratemaking. Rates are set based on the original cost of assets adjusted for accumulated depreciation. Changes in market value as represented by increases and decreases in stock prices are not reflected in rates.

(PGE/6800, Lesh-Hager/17.)

3. Income Taxes

Finally, with respect to PGE's income taxes, PGE accounted for its taxes following its acquisition by Enron in accordance with well-established Commission policies. (PGE/6800, Lesh-Hager/17-18 ("[The stand alone approach was] well established rate-making policy of the Commission when its set rates in UE 88. PGE had been consolidated for tax purposes with its then parent, Portland General Corporation (PGC") since 1986. The Commissioner approved PGC's acquisition of PGE in Order No. 86-106, entered January 31, 1986."))

The Commission Staff's White Paper ("Treatment of Income Taxes in Utility Rate Making," dated February 2005) was an authoritative examination of how consolidated taxes should be accounted for. It concluded that Oregon has used the stand-alone approach. Staff White Paper at 1 ("Most states, including Oregon, use the traditional 'stand-alone' method for calculating the amount of income taxes to be incorporated into a regulated utility company's rates.") In March 2005, the Commission made recommendations to the Oregon

legislature regarding the treatment of utility income taxes. In that report, it recognized that "today, we set the utility's rates on a stand-alone basis." There is no reason to believe the Commission would have taken a different view in 1995. The Court of Appeals' decision in CUB has no bearing on this issue.

In summary, none of the post-1995 events upon which URP dwells would have had any relevance to the Commission's ratemaking in UE 88 even if they had been known then.

VII. RELEVANT PERIOD

The issue in this phase of the proceeding is limited to what the Commission would have approved in UE 88 had it interpreted ORS 757.355 the way the Court of Appeals did. (Scope Order at 5.) Thus, the only rate-making proceeding that the Commission must reconsider is UE 88. The rates subsequently set in UE 93 and UE 100 need not be reconsidered in this phase, nor need they be reconsidered in this proceeding at all. As discussed in PGE's Opening Brief, those rates were not appealed and therefore they become conclusively final 60 days after the Commission set them. ORS 756.565, 756.580. (PGE's Opening Brief at 20-23.)

While there is no legal basis to change the rates set in UE 93 and UE 100, PGE's analytical work extends through the period that those rates were in effect for two reasons. First, in analyzing the UM 989 settlement, which will be the subject of a later phase, it is helpful to show what the financial impact over time would have been of different rate decisions in UE 88. The Commission's decision in UE 88 set in motion certain accounting and financial consequences, and the UM 989 remand instructed the Commission to consider those consequences when assessing the UM 989 settlement. Second, in the interest of efficiency, PGE suggests that the Commission make findings about how any change in UE 88 rates would have affected rates set in UE 93 and UE 100. Then, if the

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

courts should rule on appeal that the rates in those proceedings may be modified, even though they were not appealed, the Commission and the parties will not need to resubmit evidence.

The settlement in UM 989 will be an issue for a later phase of this proceeding, after the Commission determines what rates it would have set in UE 88. (Scope Order at 6.) Therefore, the Commission need not make any findings in this phase with respect to testimony offered by the parties that solely concerns the UM 989 settlement. (*See, e.g.,* URP/200, Lazar/2, 13.)

URP also offers some testimony about rates that were in effect in 1992-1995. (*See, e.g.,* URP/200, Lazar/2, 13.) There is no basis whatsoever for the Commission to reconsider rates set in proceedings prior to UE 88. The Court of Appeals' decision has no bearing on rates that were set by the Commission while Trojan was still operating. Testimony regarding the rates in effect in 1992-1995 IS beyond the scope of this phase of the docket, which requires an "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." (Scope Order at 5-6.)

VIII. CONCLUSION

The evidence in this docket establishes a range of reasonable UE 88 rates. Both Staff and PGE have presented reasonable rate-making alternatives that establish just and reasonable UE 88 rates, further important Commission policies and satisfy the criteria PGE proposes, and comply with the remand orders in DR 10, UE 88 and UM 989. The evidence also shows that the range of reasonable UE 88 rates is higher than PGE's actual UE 88 rates, demonstrating that the end result in UE 88 was just and reasonable rates. The evidence also bears directly on the UM 989 settlement. It shows that the range of reasonable UE 88 rates results in a PGE balance sheet substantially similar to PGE's actual balance at

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

the time of the UM 989 settlement. The $180 million Trojan balance that PGE and the Commission used to offset against customer credits is replaced with regulatory assets of between $198 million (PGE's one-year recovery alternative), more than $158 million (Staff's alternative), or $275 million (PGE's 17-year recovery). While the Commission will consider the UM 989 settlement in greater detail later, this range of reasonable outcomes suggests that the Commission's approval of UM 989 settlement was reasonable and that customers received a substantial benefit as result of that settlement.

PGE recommends that the Commission enter a final order adopting these recommendations and financial impacts as further set forth in the attached proposed final order (Ex. 1).

DATED this 9th day of November, 2005.

PORTLAND GENERAL ELECTRIC COMPANY

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J. Jeffrey Dudley, OSB No. 89042
121 SW Salmon Street, 1WTC1300
Portland, OR 97204
Telephone: 503-464-8926
Fax: 503-464-2200
E-Mail jay.dudley@pgn.com

TONKON TORP LLP

____

Jeanne M. Chamberlain, OSB No. 85169
Direct Dial 503-802-2031
Direct Fax 503-972-3731
E-Mail jeanne@tonkon.com
David F. White, OSB No. 01138
Direct Dial 503-802-2168
Direct Fax 503-972-3868
E-Mail davidw@tonkon.com
888 S.W. 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 OPENING POST HEARING BRIEF (PHASE I)** by mailing a copy thereof in a sealed, first-class postage prepaid envelope, addressed to each party listed below and depositing in the U.S. mail at Portland, Oregon.

David Hatton
Department of Justice
Regulated Utility & Business Section
1162 Court Street, N.E.
Salem, OR 97301-4096
stephanie.andrus@state.or.us

Paul A. Graham
Department of Justice
Regulated Utility & Business Section
1162 Court Street, N.E.
Salem, OR 97301-4096
paul.graham@state.or.us

Daniel W. Meek
Daniel W. Meek, Attorney At Law
10949 S.W. Fourth Avenue
Portland, OR 97219
dan@meek.net

Linda K. Williams
Kafoury & McDougal
10266 S.W. Lancaster Road
Portland, OR 97219-6305
linda@lindawilliams.net

DATED this 9th day of November, 2005.

TONKON TORP LLP

By ______________________________
JEANNE M. CHAMBERLAIN, OSB No. 85169
DAVID F. WHITE, OSB No. 01138
Attorneys for Portland General Electric Company

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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)	**PORTLAND GENERAL ELECTRIC COMPANY'S PROPOSED FINAL ORDER (PHASE I)**
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)	

I. PROCEDURAL HISTORY

On March 3, 2004, the Commission issued a notice of consolidated procedural conference to be held on March 18, 2004. On March 9, 2004, the Utility Reform Project ("URP") filed a motion to postpone the procedural conference. On March 11, 2004, ALJ Kirkpatrick issued a ruling postponing the consolidated procedural conference. On March 19, 2004, ALJ Kirkpatrick issued a rescheduled consolidated procedural conference to be held March 31 2004. On March 31, 2004, a consolidated procedural conference was held. On April 1, 2004, ALJ Kirkpatrick issued a consolidated procedural conference memorandum adopting a schedule for the parties to submit simultaneous opening memoranda and reply memoranda.

On March 31, 2004, Linda Williams filed a petition to intervene on behalf of Frank Gearhart, Kafoury Bros., LLP and Patricia Morgan ("Class Action Plaintiffs"). The petition to intervene was corrected on April 16, 2004.

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

On April 1, 2004, ALJ Kirkpatrick issued a memorandum to all current parties in dockets DR 10, UE 88 and UM 989 according to which all parties in these dockets, other than those that appeared at the consolidated pre-hearing conference, must give notice of their plans to participate as parties by April 12, 2004.

On April 16, 2004, PGE, URP and the Class Action Plaintiffs filed opening memoranda regarding the scope of issues to be addressed in this remand proceeding and proposed schedules. On April 16, 2004, a notice of consolidated pre-hearing conference was issued for a consolidated pre-hearing conference to be held on April 27, 2004.

On April 23, 2004, Commission Staff and PGE filed reply memoranda concerning the issues to be addressed in this docket and the procedural schedule. On April 26, 2004, URP filed its reply memorandum.

On April 27, 2004, a consolidated procedural conference was held. The Class Action Plaintiffs' notion to intervene was granted.

On May 5, 2004, ALJ Kirkpatrick issued a ruling asking the parties to address the question: "Should the Commission determine how the court's opinions and the appeals of these cases affect the rate decisions made by the Commission, in their entirety, or whether the Commission's inquiry is more ministerial, and involves only determining the charges customers paid to PGE for interest on PGE's investment in Trojan?" The ruling asked for opening memoranda on June 3, 2004 and simultaneous reply memoranda on June 24, 2004.

On June 3, 2004, Commission Staff, PGE, URP and the Class Action Plaintiffs filed opening memoranda regarding the scope of issues in this proceeding. On June 25, 2004, Commission Staff, PGE, URP and the Class Action Plaintiffs filed reply memoranda.

On August 31, 2004, ALJ Kirkpatrick issued a ruling regarding the scope of Phase I.

On September 3, 2004, ALJ Kirkpatrick signed Protective Order No. 04-502.

On September 3, 2004, a notice of pre-hearing conference memorandum was issued for a pre-hearing conference to be held on September 24, 2004. On September 13, 2004, URP filed a motion for certification of ALJ Kirkpatrick's August 31 ruling.

On September 16, 2004, ALJ Kirkpatrick issued a ruling postponing the pre-hearing conference scheduled for September 24, 2004.

On September 28, 2004, PGE filed its response to URP's motion for certification. On October 18, 2004, the Commission issued Order No. 04-597 granting certification and affirming ALJ Kirkpatrick's ruling dated August 31, 2004.

On November 9, 2004, a notice of pre-hearing conference was issued for a pre-hearing conference to be held on December 2, 2004.

On December 2, 2004, a consolidated procedural conference was held.

On December 8, 2004, a consolidated procedural conference ruling and memorandum was issued establishing a procedural schedule.

On December 20, 2004, URP and the Class Action Plaintiffs filed an application for reconsideration of Commission Order No. 04-597.

On December 21, 2004, PGE filed a request for extension of time to file a response to the application for reconsideration. On December 22, 2004, ALJ Kirkpatrick granted the request for extension. On January 14, 2005, PGE filed its opposition to the application for reconsideration. On January 18, 2005, Commission Staff filed its response to the application for reconsideration. On January 20, 2005, Commission Staff filed a motion to accept late-filed pleadings, and on January 24, 2005, ALJ Kirkpatrick issued a ruling granting Commission Staff's motion to submit late-filed pleadings.

On February 11, 2005, the Commission issued Order No. 05-091 denying URP's request for reconsideration.

On February 15, 2005, PGE submitted its opening testimony (PGE Ex. Nos. 6000, 6100, 6200, 6300, 6400, 6500, 6600, 6700, and its opening brief) and accompanying exhibits.

On April 18, 2005, URP and the Class Action Plaintiffs filed a motion for a 21-day extension of time to file testimony. On April 20, 2005, a telephone conference was held to address the motion filed by URP and the Class Action Plaintiffs. On April 28, 2005, a consolidated pre-hearing conference was held for the purpose of addressing URP's and the Class Action Plaintiffs' motion to extend the procedural schedule. On May 2, 2005, ALJ Kirkpatrick issued a ruling and consolidated pre-hearing conference memorandum in which a revised procedural schedule was adopted.

On May 19, 2005, URP submitted its opening testimony and exhibits (URP/200-202 and URP/204-205). On May 19, 2005, Commission Staff filed its opening testimony (Staff/100-102 and Staff/200-202).

On June 14, 2005, PGE filed a motion to strike certain portions of Mr. Meek's testimony (URP/204).

On June 27, 2005, PGE filed its rebuttal testimony (PGE Exhibit Nos. 6800, 6900 and 7000), along with accompanying exhibits.

On June 29, 2005, URP filed a motion to compel PGE answers to URP's third discovery request.

On June 29, 2005, URP filed a motion for extension of time to respond to PGE's motion to strike and request to waive the requirement of filing a paper copy. On June 30, 2005, ALJ Grant granted URP's motion for an extension of time and granted URP's waiver of paper filing.

On July 1, 2005, ALJ Grant issued a ruling revoking the waiver of paper filing requirement and requiring Mr. Meek to file a show cause response as part of URP's July 8, 2005 response to PGE's motion to strike.

On July 8, 2005, URP filed a response to PGE's motion to strike and its response to the July 1 show cause order.

On July 13, 2005, PGE filed an opposition to URP's motion to compel. On July 13, 2005, URP filed a reply in support of its motion to compel. On July 15, 2005, PGE filed a surreply in opposition to URP's motion to compel and a motion to strike or, in the alternative, grant PGE leave to file its surreply.

On July 25, 2005, ALJ Grant issued a ruling granting PGE's motion to strike and denying URP's motion to compel.

On July 25, 2005, URP filed a motion for a three-day extension of time to file surrebuttal testimony. On July 28, 2005, PGE filed a response to URP's motion for an extension of time. On July 28, 2005, ALJ Grant issued a ruling granting URP's motion for an extension of time.

On August 1, 2005, Commission Staff submitted its surrebuttal testimony (Staff/300 and Staff/400-401). On August 1, 2005, URP submitted its surrebuttal testimony (URP/300 and URP/400). On August 1, 2005, the Class Action Plaintiffs submitted a statement sponsoring and adopting the surrebuttal testimony filed on behalf of URP.

On August 16, 2005, cross-examination statements were filed on behalf of Commission Staff, PGE, URP and the Class Action Plaintiffs.

On August 22, 2005, URP and the Class Action Plaintiffs submitted a revised cross-examination statement.

On August 23, 2005, PGE submitted its sursurrebuttal testimony (PGE Ex. No. 7100).

On August 23, 2005, URP filed an emergency motion for clarification and relief from orders of July 25 and August 23, 2005. On August 23, 2005, ALJ Kirkpatrick issued a corrected memorandum regarding cross-examination schedule, affidavits to be filed in place of cross-examination, and compliance of Mr. Meek's testimony with Rule 3.7 of the Oregon Rules of Professional Conduct.

On August 24, 2005, PGE filed a comment on URP's emergency motion for clarification and relief.

On August 25, 2005, PGE filed a motion in limine.

On August 26, 2005, ALJ Kirkpatrick issued a ruling clarifying the prior procedural rulings regarding Mr. Meek's testimony and compliance with Oregon Rules of Professional Conduct, Rule 3.7.

On August 26, 2005, URP filed a notice regarding ALJ Kirkpatrick's clarification.

On August 29 and 30, 2005, a hearing was conducted during which Ms. Williams and Mr. Meek cross-examined PGE witnesses and Commission Staff witnesses. ALJ Kirkpatrick left the record open for certain post-hearing submissions.

On August 31, 2005, URP filed a motion for extension of time to file post-hearing documents. On September 1, 2005, ALJ Kirkpatrick issued a post-hearing memorandum and ruling granting URP's motion for an extension of time to file post-hearing documents. On September 6, 2005, URP filed an affidavit of Jim Lazar adopting pre-filed testimony, a motion to strike certain portions of testimony, and notices and affidavits in support of its request that Mr. Meek be allowed to submit testimony in this docket.

On September 8, 2005, URP submitted an affidavit of Daniel Meek adopting pre-filed testimony.

On September 9, 2005, Commission Staff and PGE filed responses to URP's motion to strike.

On September 19, 2005, ALJ Kirkpatrick issued a ruling closing the record, denying URP's motion to strike, declining to accept the testimony of Mr. Meek into the record, and establishing a briefing schedule.

II. [SUMMARY OF THE PARTIES' POSITIONS]

[INTENTIONALLY LEFT BLANK]

III. COMMISSION ANALYSIS AND DISCUSSION

The Commission concludes that PGE and Staff have presented three alternatives that provide a range of reasonable UE 88 revenue requirements. The three alternatives are PGE's one-year alternative, Staff's one-year alternative as modified according to PGE's recommendations, and PGE's 17-year alternative[1]. UE 88 rates set using these alternatives would have been just and reasonable.

While we conclude that each alternative provides a reasonable UE 88 revenue requirement that is consistent with the remand orders in DR 10, UE 88 and UM 989, the applicable legal standard and the Commission's regulatory policies, we find that PGE's one-year alternative is the preferred approach.

We analyzed the alternatives and their component parts (building blocks) using three regulatory policies or criteria. These three criteria are as follows:

1. Does the alternative encourage electric utilities to analyze and make resource decisions that would yield an adequate and reliable supply of energy at the least-cost to the utility and its customers consistent with the long-run public interest?

2. Does the alternative equitably allocate the costs and benefits of utility resource decisions to customers over time?

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[1] The precise components of each alternative are set forth in the conclusion of this order.

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3. Does the alternative preserve the utility's financial integrity and ability to attract debt and equity capital so that it can provide safe, reliable and adequate utility service to customers over time at reasonable rates?

Using these three criteria, we find that the three approaches offered in this docket provide a reasonable range for the UE 88 revenue requirement. In particular, we find that each approach is consistent with providing utilities an incentive to acquire resources consistent with least-cost planning principles. Moreover, we find that all three alternatives reasonably allocate the costs and benefits of PGE's resource decisions to customers over time. Finally, we find that each alternative preserves PGE's financial integrity, permitting PGE to provide adequate, safe and reliable utility service to customers.

While all three alternatives satisfy the three criteria we apply in this docket, we note that PGE's 17-year recovery alternative is not the preferred outcome. A 17-year recovery period alternative would have imposed a substantial disallowance on PGE at the time of the UE 88 decision, even when combined with the building blocks PGE recommends. Such a substantial disallowance, which would not be based on a finding of imprudence, places a strain on least-cost planning principles. Nevertheless, we conclude that PGE's 17-year alternative provides a reasonable approach and would establish a reasonable UE 88 revenue requirement.

We address below the particular rate making tools and building blocks that are components of the three alternatives identified above.

A. RECOVERY PERIOD

We conclude that a one-year recovery period for PGE's undepreciated investment in Trojan is the preferable alternative, assuming that a retired plant such as Trojan may not be included in rate base. A one-year recovery period is the best alternative to meet the twin requirements of the Court of Appeals' decision, which held that (1) PGE should be

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permitted to recover its undepreciated investment in Trojan; and (2) PGE should not be permitted to earn a return on Trojan. Moreover, a one-year recovery period is more consistent with the first criteria identified above, *i.e.*, encouragement of least-cost planning principles. All else remaining the same, a 17-year recovery period with no return on the Trojan investment would require an initial disallowance of approximately $182 million. Such a disallowance would not be based on an imprudence finding or violation of least-cost planning principles. Indeed, retirement of Trojan would create a substantial net benefit for customers. Under these circumstances, it is difficult to reconcile a 17-year recovery period with least-cost planning principles.

B. NET BENEFITS TEST

In UE 88, the Commission disallowed recovery of $26.8 million (before taxes) on the basis of the net benefits test. The net benefits test compared how customers fared under a Trojan closure scenario with a no-closure scenario. In the net benefits test performed in UE 88, the Commission assumed that in the closure scenario, PGE would be able to recover a return on its undepreciated investment in Trojan. This assumption is no longer justified given the Court of Appeals' decision. Accordingly, we conclude that the Commission would have performed the net benefits test differently in UE 88 had it known that it could not set rates to include a "return on" PGE's undepreciated investment in Trojan. Based on our conclusions elsewhere in this order that $80 million of the Trojan assets should be classified as plant-in-service and that PGE would have been permitted to recover the Trojan investment in one year, the value to customers of such a delay in recovery with no return on Trojan is approximately $17.66 million. Accordingly, on this basis alone, we reverse the $26.8 million disallowance in UE 88 by at least $17.6 million.

We also conclude that we would have exercised our discretion differently with respect to the Commission's decision to exclude the entire cost of replacing Trojan's steam

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generators from PGE's cost of continued Trojan operation. In the net benefits test applied in UE 88, the Commission exercised its discretion to not recognize the cost of replacing Trojan's steam generators in the no closure scenario. In Order No. 95-322, the Commission recognized that this decision was an exercise of its discretion and was not based on a finding of imprudence. Indeed, the Commission's standard cost-of-service convention includes such prudently-incurred costs in rates. We conclude that the Commission would not have exercised its discretion in this fashion had it known that rates could not be set to include a return on PGE's undepreciated investment in Trojan. Including the entire prudent cost related to replacement of Trojan's steam generators increases the benefits of closure by $183 million, resulting in a large net benefit to customers. This results in a substantial benefit to customers under either a one-year or 17-year recovery period and justifies reversal of the entire $26.8 million disallowance in UE 88 based on the net benefits test.

C. PLANT-IN-SERVICE

In its initial decision in UE 88, the Commission determined that the accounting classification of Trojan assets would have no effect on rates and, therefore, the Commission classified these assets as abandoned rather than as plant-in-service. The Court of Appeals' decision undermines the basis for the Commission's resolution of this issue. Classification of the Trojan assets to be used for safety, environmental protection and decommissioning as plant-in-service would have an impact on rates given the Court of Appeals' decision that only investments in assets that are "used and useful" may be included in rate base. Accordingly, we reaffirm our decision in UE 88 that assets associated with the Trojan investment provide service necessary for safety, environmental protection and decommissioning. We conclude, based on the record in this remand docket, that $80 million of the Trojan assets would have been classified as plant-in-service had the Commission in UE 88 known of the Court of Appeals' decision.

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D. BALANCE SHEET OPTIONS

At the time of the UE 88 decision, PGE's balance sheet included a customer credit of $111 million from the sale of Boardman, which was being amortized over a 27-year period ending in 2013. We conclude that the Commission would have offset the remaining Boardman credit against an equal amount of undepreciated Trojan investment in UE 88 had it known that ORS 757.355 precluded the Commission from setting rates that included a return on PGE's undepreciated investment in Trojan. This offsetting of the balance sheet entries would have served a number of important regulatory principles. First, it would have lessened PGE's loss from the delayed recovery of its prudent investment in Trojan and therefore would have furthered important least-cost planning principles. Second, with a relatively short recovery period for the Trojan investment (such as one year), the offset would have reduced the rate impact and kept rates stable. Finally, when combined with a one-year recovery period for the Trojan investment, the offset would have served the goal of intergenerational equity among customers because the Boardman sale and the Trojan closure affected customers over the same period of time. The recovery period for Trojan ended in 2011; the recovery period for Boardman ended in 2013.

The Commission has broad discretion to prescribe accounting rules for recovery and depreciation. We conclude that the Commission would have exercised this authority by offsetting the entire Boardman gain credit against the Trojan balance in UE 88.

We also conclude that the Commission could have exercised its discretion to defer a certain portion of the UE 88 test year power costs, as PGE recommends. This deferral is appropriate under ORS 757.259(2)(e) in order to assist in stabilizing rates. Because a one-year recovery period for Trojan could cause a short term rise in rates, it would have been reasonable for the Commission in UE 88 to exercise its discretion to defer these power costs in order to smooth rates. In this remand docket, we do not decide whether or not

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the Commission in UE 88 would have in fact adopted a power cost deferral. We simply conclude that establishing a power cost deferral in UE 88 would have been a reasonable alternative. In this regard, we note that the power cost deferral is used in only one of the three alternatives (PGE's one-year recovery period alternative) that establish the range of reasonable UE 88 revenue requirements.

E. RETURN ON EQUITY AND CAPITAL STRUCTURE

PGE's authorized return on equity was established in UE 88 based on the assumption that the Commission would allow PGE to recover its undepreciated investment in Trojan over time with a return. Now that the Court of Appeals has reversed this fundamental assumption, it is appropriate to reconsider what authorized ROE the Commission would have established for PGE in UE 88. We conclude, based on the record evidence, that the Court of Appeals' decision might have increased the required rate of return that investors demand for investing in PGE and Oregon utilities. Investors would likely view PGE as an above-average risk relative to other utilities, increasing the required rate of return on equity. We conclude that the Commission would have increased PGE's required ROE by between 25 and 150 basis points, depending upon the degree to which PGE's recovery of its investment in Trojan is delayed. Over a one-year scenario, the Commission would have increased PGE's required ROE by 25 basis points. Under a 17-year recovery period, we conclude based on the record evidence that the Commission would have increased PGE's required ROE by 150 basis points.

IV. URP'S AND CLASS ACTION PLAINTIFFS' ARGUMENTS

The vast majority of the opposition argument and testimony filed on behalf of URP and the Class Action Plaintiffs blatantly disregards the Commission's prior conclusion regarding the scope of this docket. URP continues to argue that the Commission should limit itself to a ministerial function. According to URP, the Commission should simply calculate

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the return on Trojan charged to customers while ignoring the impact the Court of Appeals' decision would have had on other elements the Commission analyzed in its efforts to set fair and reasonable rates in UE 88. We incorporate by reference our scoping order, which responded to and resolved URP's arguments on this front.

Suffice it to say, we conclude that (a) we must engage in ratemaking in this docket under our general powers (ORS 756.040) and our specific rate making powers (ORS 757.210 and ORS 757.020); (b) our obligation is to establish what would have been "just and reasonable rates" in UE 88; and (c) we are not confined to a single rate-making component or issue. We have broad discretion in deciding the scope of this proceeding, the additional evidence received into the record, and what findings to make in this remand proceeding. Our discretion is enhanced under these unprecedented circumstances. We have never engaged in a remand proceeding in which the purpose was to consider refunds.

A. DEFERRED TAXES AND CAPITAL STRUCTURE

Mr. Lazar testifies that customers are entitled to the accumulated deferred taxes associated with Trojan and an adjustment to PGE's capital structure. We conclude that both adjustments are unwarranted. They rely on the mistaken assumption that the Court of Appeals' decision required a complete write-off of the undepreciated investment in Trojan. This assumption is wrong. The Court of Appeals' decision concluded that PGE was entitled to recover its undepreciated investment in Trojan.

B. POST-1995 EVENTS

In determining what rates the Commission would have established in UE 88 had it known of the Court of Appeals' decision, URP urges the Commission to consider several events that occurred after 1995. Consideration of these post-1995 events is improper because the Commission's task in this proceeding is to determine what rates would have been approved in UE 88 had the Commission known of the Court of Appeals' decision. The

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Commission could not possibly have known in 1995 about events that occurred later. Accordingly, we conclude that URP's testimony and arguments relating to post-1995 events are irrelevant. Nevertheless, even if we had considered these events, we conclude that they provide no basis for setting just and reasonable rates.

1. Earnings

Even it were proper for the Commission to consider post-1995 events, URP's testimony regarding earnings after 1995 provides no legitimate basis for determining UE 88 rates. It is an inherent element in utility rate regulation that actual conditions effecting costs and revenues will vary from test year conditions. Nonetheless, neither the utility nor its customers can recover for these fluctuations unless affirmative steps are taken under ORS 757.259. While PGE's earnings may have been somewhat higher than expected in the years following UE 88, PGE's earnings in other years have been lower than expected. These fluctuations provide no basis for the Commission's decision in establishing what just and reasonable rates it would have set in UE 88.

2. Enron Acquisition

The price paid by Enron to acquire PGE stock in 1997 does not bear on any issue relevant to a rate-making proceeding. Gains and losses on stock sales are not recognized for rate-making purposes, nor are changes in the market value of assets.

3. Income Taxes

URP suggests that the Commission, in setting UE 88 rates, should consider actual tax payments by Enron and PGE after 1995. We conclude that this does not provide a relevant factor in setting UE 88 rates. Until the Oregon legislature's enactment of SB 408 in the 2005 legislative session, the Commission consistently applied a stand-alone approach for calculating income taxes. There is no basis to conclude that the Commission in UE 88 would have done anything different.

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C. RELEVANT PERIOD

The issue in this phase is limited to what the Commission would have approved in UE 88 had it interpreted ORS 757.355 in the way the Court of Appeals did. Accordingly, we need not consider in this docket what rates it would have established in UE 93 or UE 100. Nevertheless, the Commission must consider the rate-making and financial consequences of alternative UE 88 rates through the period from 1995 until the time of the UM 989 settlement. This remand proceeding requires an analysis of the UM 989 settlement based on revised UE 88 revenue requirements. It is, therefore, necessary to show the financial, accounting and rate-making impact over time that would have resulted from different rate decisions in UE 88.

URP submits testimony and comments regarding the specific mechanics of the UM 989 settlement. The Commission will consider in detail the UM 989 settlement later in this docket. Therefore, the Commission need not make any findings in this phase with respect to testimony offered by the parties that solely concern the mechanics of the UM 989 settlement.

URP also offers testimony and comments regarding rates that were in effect in 1992-1995, before UE 88. We find that this testimony is outside the scope of this docket. There is no basis for the Commission to reconsider rates in this proceeding prior to UE 88.

V. CONCLUSION

The Commission finds that had it known that ORS 757.355 did not permit it to set rates to include a return on PGE's undepreciated investment in Trojan, it would have set UE 88 rates to:

1. Recover the entire undepreciated investment in Trojan based on the positive net benefit resulting from comparing the cost of closure to the cost of continued operation and including the effects of the Court of Appeals' interpretation in the cost of closure and steam generator replacement in the cost of continued operation;

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2. Leave $80 million of the Trojan assets in the plant-in-service accounts;

3. Offset the $111 million Boardman gain against the undepreciated Trojan assets that were not still plant-in-service and amortize the remainder over one year;

4. Authorize return on equity of 11.85 percent;

5. Defer a portion of its 1995 and 1996 net variable power costs, for recovery over the subsequent 10 years; and

6. Recover the AMAX termination payment, pre-UE 88 deferred power costs and SAVE incentive over the same 10 years.

This is the Commission's preferred alternative. In addition, the Commission finds that there were other reasonable alternative UE 88 revenue requirements. These include one of the combination of building blocks put forward by Staff (modified as PGE suggests):

1. Recover the entire undepreciated investment in Trojan based on the positive net benefit resulting from comparing the cost of closure to the cost of continued operation and including the effects of the Court of Appeals' interpretation in the cost of closure and steam generator replacement in the cost of continued operation;

2. Leave $80 million of the Trojan assets in the plant-in-service accounts;

3. Offset the $111 million Boardman gain against the undepreciated Trojan assets that were not still plant-in-service and amortized the remainder over one year;

4. Recover the AMAX termination payment, pre-UE 88 deferred power costs and SAVE incentive over the same 10 years; and

5. Authorize return on equity of 11.85 percent.

The Commission also finds the 17-year recovery alternative put forward by PGE would have provided the basis for just and reasonable rates. This option includes the following building blocks:

1. Recover the entire undepreciated investment in Trojan based on the positive net benefit resulting from comparing the cost of closure to the cost of continued operation and including the effects of the Court of Appeals' interpretation in the cost of closure and steam generator replacement in the cost of continued operation;

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2. Receive 20 percent of the positive net benefit created through its economic retirement of Trojan, spread evenly over 17 years;

3. Leave $80 million of the Trojan assets in the plant-in-service accounts;

4. Offset the $111 million Boardman gain against the undepreciated Trojan assets that were not still plant-in-service;

5. Be allowed a required return on equity of 13.1 percent; and

6. Recover the AMAX termination payment, pre-UE 88 deferred power costs and SAVE incentive over three years beginning with UE 88 rates.

We conclude that UE 88 rates set using the three alternatives described above would have been just and reasonable. The Commission finds that, under each of the these three reasonable alternatives, the UE 88 revenue requirement would have been higher than the actual UE 88 revenue requirement set in 1995. PGE's one-year recovery alternative results in a UE 88 revenue requirement that is $6.5 million higher; the second one-year recovery alternative (the modified version of Staff's alternative) is at least $75 million higher; and PGE's 17-year recovery period alternative is $63,000 higher. Accordingly, we conclude that the rates set in UE 88 were just and reasonable because they were lower than the rates the Commission otherwise would have established.

We make the following findings to facilitate our review in future phases of the UM 989 settlement. Under the PGE one-year recovery approach, as of September 30, 2000, customers would have owed PGE approximately $198 million instead of the $180 million Trojan balance that was used to offset against customer credits in the UM 989 settlement. Under the second alternative described above, as of September 30, 2000, customers would have owed an amount greater than $158.9 million. The exact amount owed under this alternative must be established in subsequent phases of this docket given that none of parties conducted a quantitative analysis showing the appropriate balance assuming this precise combination of building blocks. Under PGE's 17-year recovery alternative, as of

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September 30, 2000, customers would have owed PGE about $275 million at the time of the UM 989 settlement.

IT IS SO ORDERED

Made, entered, and effective ____.

________________________	________________________
Lee Beyer Chairman	**John Savage** Commissioner
	________________________ **Ray Baum** Commissioner

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

CERTIFICATE OF SERVICE

I hereby certify that on this day I served the foregoing **PORTLAND GENERAL ELECTRIC COMPANY'S PROPOSED FINAL ORDER (PHASE I)** by mailing a copy thereof in a sealed, first-class postage prepaid envelope, addressed to each party listed below and depositing in the U.S. mail at Portland, Oregon.

David Hatton
Department of Justice
Regulated Utility & Business Section
1162 Court Street, N.E.
Salem, OR 97301-4096
stephanie.andrus@state.or.us

Paul A. Graham
Department of Justice
Regulated Utility & Business Section
1162 Court Street, N.E.
Salem, OR 97301-4096
paul.graham@state.or.us

Daniel W. Meek
Daniel W. Meek, Attorney At Law
10949 S.W. Fourth Avenue
Portland, OR 97219
dan@meek.net

Linda K. Williams
Kafoury & McDougal
10266 S.W. Lancaster Road
Portland, OR 97219-6305
linda@lindawilliams.net

DATED this 9th day of November, 2005.

TONKON TORP LLP

By ______________________________
JEANNE M. CHAMBERLAIN, OSB No. 85169
Attorneys for Portland General Electric Company

001991\00226\654587 V003

1600 Pioneer Tower
888 SW Fifth Avenue
Portland, Oregon 97204
503.221.1440

DAVID F. WHITE

503.802.2168
FAX 503.972.3868
davidw@tonkon.com

November 9, 2005

VIA E-FILING & FIRST CLASS MAIL

Oregon Public Utility Commission
Attn: Filing Center
550 Capitol St. NE, Suite 215
P. O. Box 2148
Salem, Oregon 97308-2148

Re: *UE 88/DR 10/UM 989*

Attention Filing Center:

Enclosed for filing in the above-referenced docket are the original and five copies of Portland General Electric Company's Opening Post Hearing Brief (Phase I). This document is being filed electronically per the Commission's eFiling policy to the electronic address PUC.FilingCenter@state.or.us, with copies being served on all parties on the service list via U.S. Mail. A photocopy of the PUC tracking information will be forwarded with the hard copy filing.

Very truly yours,

David F. White

DFW/ldh
Enclosures
cc: Service List
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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)	**PORTLAND GENERAL ELECTRIC COMPANY'S OPENING POST HEARING BRIEF (PHASE I)**
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)	

I. INTRODUCTION

Portland General Electric Company ("PGE") submits this Opening Brief to describe the issues that the Commission must decide in Phase I of this proceeding and to summarize PGE's recommendations.

II. LEGAL STANDARD

This is a remand proceeding in which the Commission must exercise its rate-making authority. To decide what rates should be today (*i.e.*, whether there is any basis for a refund), the Commission must decide what rates it would have established in UE 88 had it known that ORS 757.355 prohibited a "return on" Trojan. As in any rate-making proceeding, the Commission must fulfill its obligations under its general grant of authority to further the interests of utility customers and shareholders (ORS 756.040), while establishing rates that are "just and reasonable" under its specific rate-making power (ORS 757.210 and ORS 757.020).

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

III. SCOPE OF PROCEEDING

The scope of this proceeding has already been the subject of extensive comments and Commission rulings and orders. An ALJ ruling, a Commission Order affirming the ALJ Ruling, and another Commission order rejecting URP's application for reconsideration have all described the task before the Commission and the parties. ALJ Ruling dated August 31, 2004 ("ALJ Ruling"); Commission Order No. 04-597 ("Scope Order"); Commission Order No. 05-091. The work of this phase is:

> To undertake 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.

From this simple statement flow several important implications. First, it requires the Commission to engage in ratemaking under the Commission's broad authority to set just and reasonable rates. Commission Order No. 04-597 at 6 ("We also agree with the ruling 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."). The Commission has its broadest degree of discretion when acting in its legislative rate-making role, a principle the Oregon courts have embraced repeatedly: "ratemaking is a purely legislative function, involving broad discretion in selecting policies and methods." *American Can Co. v. Lobdell*, 55 Or App 451, 463, 638 P2d 1152 (1982). As long as the Commission acts within constitutional and legislative restraints, it is not "obligated to employ any single formula or combination of formulas to determine what are in each case 'just and reasonable rates.'" *Pacific Northwest Bell Telephone Co. v. Sabin*, 21 Or App 200, 224, 534 P2d 984 (1975).

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Second, the Commission and parties are not confined to a single rate-making component or issue. Rather, the Commission must consider all relevant aspects of the utility's circumstances to determine a revenue requirement that furthers the interests of utility shareholders and customers and provides the basis for just and reasonable rates. Anything less would constitute "single-issue ratemaking, which is prohibited." Order No. 04-597 at 6. In deciding upon the scope of this proceeding, the Commission has broad discretion. It is for the Commission to determine what additional evidence to receive and what findings to make in this remand proceeding. *Pacific Tel. & Tel. Co. v. Hill*, 229 Or 437, 486, 367 P2d 790 (1962).

Third, the Commission need not duplicate every aspect of the UE 88 general rate case. This proceeding is limited to those "aspects of the ratemaking process in UE 88 that are affected by the Court of Appeals' statutory interpretation of ORS 757.355." Order No. 04-597 at 6. The Commission's Scope Order identified three such issues—the appropriate recovery period for the Trojan investment balance, the cost of capital, and the application of the net benefits test—but the Commission invited the parties to raise any other rate-making issues consistent with the "general framework of the scope for the first phase." *Id.* at 7.

The Commission's task in this phase, as set forth in the Scope Order, is consistent with the remand orders in DR 10, UE 88 and UM 989. In the DR 10 and UE 88 dockets, the Court of Appeals identified the "principal if not only issue before" it was "whether PGE's rates may include the rate of return component or are instead limited to recovery of the declining principal amount of the undepreciated Trojan investment." *Citizens' Utility Board*, 154 Or App at 706-07. The Court of Appeals concluded that ORS 757.355 limited the Commission's authority and prevented it from approving rates that included a rate of return component for facilities that were not in service. As the

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Commission concluded in the Scope Order, "the orders in DR 10 and UE 88 were reversed solely on the grounds that the Commission had exceeded its legislative authority." Order No. 04-597, Appendix A at 15. The Court of Appeals made no determination, and provided no guidance, regarding whether the end rates established in UE 88 were just and reasonable.

The Circuit Court remand of the UM 989 final order is also instructive. The Circuit Court faulted the Commission for considering only the prospective treatment of Trojan while ignoring amounts collected from customers in the period preceding UM 989. The ALJ's ruling covering scope, which the Commission affirmed and adopted in Order No. 04-597, observed:

> To approve end rates within this scope, however, the Commission would have had to conduct far different proceedings than those actually conducted in UM 989. In reviewing the settlement, the Commission needed to address the following question: What rates would have been approved in UE 88 if the Commission had interpreted the authority delegated to it in ORS 757.355 as the Court of Appeals did in the Citizens' Utility Board?

ALJ Ruling at 15.

The Circuit Court anticipated that the Commission would engage in just such a rate-making analysis in this remand proceeding:

> At the Commission you [PGE] can argue . . . if you can't give us [a return on the Trojan investment], you have to give us something else, because otherwise we aren't made whole . . . And that's probably what you're going to do . . . And that may or may not result in any net rate relief.
>
> I'm not prepared to buy off on that today, but I am certainly not prepared to conclude that you can't argue on remand to the PUC that if you can't get a return on your investment, they need to put something else in your [rate] base for some other reason that . . . allows you to have . . . a rate of return that's economically viable for you to continue on as a successful utility company.

July 23, 2003 Hearing Tr. at 177, 179 (quoted in Scope Order at 6).

The Commission sets rates using a two-step process. First it establishes a revenue requirement figure. Second, it allocates that revenue requirement among ratepayers. There are no rate spread issues in this docket. The focus of the evidence PGE presents is determining what the revenue requirement would have been in UE 88 and tracking the rate-making and accounting impacts that follow. Future phases of this remand proceeding will address reconciling the results of Phase I with actual rates, the Commission's legal authority to issue refunds (if earlier phases support refunds), and administration of any refunds. ALJ Ruling at 19.

IV. PGE'S RECOMMENDATIONS

A. PGE'S RECOMMENDED FRAMEWORK

In UE 88, the Commission considered a number of issues, such as the recovery period for PGE's investment in Trojan, a return on the remaining Trojan balance, characterization of the remaining investment in Trojan, the net benefits test, and potential offsets. The Commission did not make decisions with respect to each of these issues in isolation. Rather, the Commission attempted to resolve them to create rates that achieved (1) its overarching goals of safe and adequate utility service for customers over time at reasonable rates and (2) its objectives of ensuring utilities such as PGE continued to make resource decisions that provided net benefits to customers while achieving relative stability and intergenerational equity in rates. In other words, there was no single "right" answer to many important questions in UE 88, such as over how long PGE should recover the undepreciated Trojan investment or whether the Trojan balance should be offset against available customer credits. The Commission could have used different combinations of decisions to achieve its rate-making goals.

Now the Commission must revisit the rates it set in UE 88 and determine how it would have set rates if it could not use one of the tools it relied on then—allowing a return

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on PGE's remaining undepreciated investment in Trojan. The Commission would have had to resolve the other issues, or building blocks, in a different way.

There are several principles that should guide the Commission in making decisions that serve its overarching goals in this remand proceeding. Some flow from the legal rulings in this docket, others reflect general Commission policies. With respect to legal decisions in this docket, the Court of Appeals decided both (1) that rates may not include a return on retired plant, and (2) that PGE is entitled to recover the undepreciated investment in Trojan. 154 Or App at 714. URP argued in the appeal of Order No. 95-322 that the utility statutes barred PGE from recovering first a "return on" and second a "return of" its investment balance in the Trojan facility. The Court of Appeals accepted the first but rejected the second argument, concluding that PGE should be permitted to recover its principal investment. *Id.* In this docket, PGE and Staff both have recommended combinations of rate-making tools that satisfy the Court of Appeals' twin requirements.

In addition to these legal rulings, traditional rate-making policies guide the Commission. At the core, the Commission's decisions must serve both customers' interests in adequate, safe service at fair, reasonable rates and shareholders' interests in earnings that are commensurate with the returns on investment in comparable businesses and the need to preserve the utility's financial integrity, maintenance of credit, and attraction of capital. (PGE/6000, Lesh/7.)

To implement this first principle of ratemaking and establish the rates customers pay, the Commission utilizes a variety of regulatory frameworks and conventions. Regulatory frameworks are paradigms the Commission uses, such as integrated resource or least cost planning, that guide but do not necessarily determine a particular rate-making outcome. *Id.* Conventions are practices the Commission normally applies, such as cost of service or the choice of a test year, unless there is a good reason to depart from the customary

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practice. *Id.* In this docket, the Commission must replace the convention it adopted in DR 10, according to which PGE could recover its Trojan investment through 2011 while earning a return on the investment.

PGE recommends that the Commission consider three criteria when crafting an alternative rate-making convention in this docket: First, the decision should encourage electric utilities to analyze and make resource decisions that will:

> yield an adequate and reliable supply of energy at the least cost to the utility and its customers consistent with the long-run public interest.

(PGE/6000, Lesh/14-15.) Put simply, the decision should further the Commission's least-cost planning principles. Second, the decision should equitably allocate the costs and benefits of utility resource decisions over time, answering the question:

> Does this decision equitably allocate the costs and benefits of utility resource decisions to customers over time, such that no one 'generation' of customers bears an inequitable burden of the costs or receives an inequitable share of the benefits?

Id. Third, the decision should preserve the utility's financial integrity and ability to attract debt and equity capital, answering the question:

> Does this decision preserve the utility's financial integrity and ability to attract debt and equity capital so that the adequacy and cost of service to future customers is not compromised?

Id.

Using these criteria, PGE recommends that the Commission identify a range of possible outcomes for UE 88 rates. (PGE/6800, Lesh/3.) Unlike a general rate case, in this remand proceeding the Commission need not establish a single UE 88 revenue requirement. The evidence in this docket supports a range of reasonable alternative UE 88 rates. The Commission need not choose from among these alternatives because they all demonstrate the same thing. They all show that UE 88 rates were just and reasonable, and they all leave PGE's balance sheet in roughly the same position at the time of the UM 989

settlement. (PGE/6800, Lesh-Hager/3 ("As a policy matter, PGE believes that the Commission can and should evaluate the reasonableness of the UM 989 settlement using a range of possible outcomes for the UE 88 remand.")) Accordingly, there is no need for the Commission to choose among the available alternatives that are within the range of reasonableness.

B. RECOMMENDED RATE-MAKING TOOLS AND FINANCIAL IMPACTS

1. Rate-making Tools

Based on the above requirements and considerations, PGE recommends that the Commission find that PGE's UE 88 revenue requirement would have been set to:

1. Recover the entire undepreciated investment in Trojan in one year, based on (a) the positive net benefit resulting from comparing the cost of closure to the cost of continued operation[1] and (b) including the effects of the Court of Appeals' interpretation in the cost of closure and steam generator replacement in the cost of continued operation;
2. Leave $80 million of the Trojan assets in the plant-in-service accounts;
3. Offset the $111 million Boardman gain against the undepreciated Trojan assets that were not still plant-in-service and amortize the remainder over one year;
4. Authorize return on equity of 11.85 percent, a twenty-five (25) basis point increase over the return on equity used in UE 88;
5. Defer a portion of its 1995 and 1996 net variable power costs, for recovery over the subsequent 10 years; and
6. Recover the AMAX termination payment, pre-UE 88 deferred power costs and SAVE incentive over the same 10 years.

The above set of building blocks is PGE's preferred alternative. Nevertheless, there are other reasonable options that PGE supports, one of which Commission Staff

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[1] The costs compared are the total costs and total impact on customers of each alternative. The cost of closure includes recovery of Trojan's undepreciated balance plus the projected cost of replacement power resources. The cost of continued operation includes a return of and a return on Trojan's asset balance as a power plant operated for the benefit of customers.

proposed. This proposal uses a modified set of building blocks. The principal changes Staff makes to PGE's recommendation are to do away with the rate-smoothing use of power cost deferrals for 1995 and 1996 (No. 5 above), eliminate the 25 basis point increase in allowed return on equity (No. 4 above), and reduce recovery of the original net benefits test disallowance to $17.7 million instead of eliminating the entire $26.8 million disallowance (No. 1 above). (Staff 100/Busch-Johnson/22-23.) Although PGE generally supports Staff's approach as a reasonable alternative (PGE/6800, Lesh-Hager/4), PGE maintains that (1) the evidence supports a 25-basis point increase in the authorized return on equity and (2) the entire net benefits' disallowance should be restored because of the steam generator replacement costs that would have been incurred under the "no-closure" scenario. (*Id.* at 4-6.)

PGE also supports a 17-year recovery period alternative. This option includes the following building blocks:

1. Recover the entire undepreciated investment in Trojan over 17 years, based on (a) the positive net benefit resulting from comparing the cost of closure to the cost of continued operation and (b) including the effects of the Court of Appeals' interpretation in the cost of closure and steam generator replacement in the cost of continued operation;

2. Receive 20 percent of the positive net benefit created through its economic retirement of Trojan, spread evenly over 17 years;

3. Leave $80 million of the Trojan assets in the plant-in-service accounts;

4. Offset the $111 million Boardman gain against the undepreciated Trojan assets that were not still plant-in-service;

5. Be allowed a required return on equity of 13.1 percent; and

6. Recover the AMAX termination payment, pre-UE 88 deferred power costs and SAVE incentive over three years beginning with UE 88 rates. (PGE/6000, Lesh/43-44.)

Although this alternative is reasonable, PGE's proposed one-year recovery approach is preferable. A 17-year recovery period would have resulted in a significant initial

write-off of PGE's undepreciated investment in Trojan that is difficult to reconcile with least-cost planning and IRP principles and could jeopardize the financial integrity of the utility. As Ms. Lesh testified:

> This scenario makes it harder to answer the question [least-cost planning criteria] positively because, regardless of some of the positive regulatory policies assumed in this scenario, the results in 1995 would have been a $71 million write-off for PGE. The opportunity to earn on equity adjusted for the increased risk investors faced and the share-the-savings payment would have increased the return investors had an opportunity to earn but such results would have come only over time and subject to the outcome of other risks PGE faced.

(PGE/6000, Lesh/44.)

2. Financial Impacts

In addition to finding that the above proposals establish a reasonable range of rates for UE 88, we also recommend that the Commission conclude in this phase that adoption of these building blocks would have the following financial impacts:

First, using either of PGE's two approaches or Staff's alternative building blocks, the UE 88 revenue requirement would have been higher than the actual UE 88 revenue requirement determined in 1995. (PGE/6200, Tinker-Schue-Hager/30-34; Staff/102, Busch-Johnson/3 (column A, row 15).) PGE's one-year recovery recommendation results in a UE 88 revenue requirement that is $6.5 million higher; Staff's alternative is at least $75 million higher[2]; and PGE's 17-year recovery period alternative is $63,000 higher.[3] This financial impact is important. It demonstrates that UE 88 rates were just and reasonable because they were lower than the rates the Commission otherwise would have established.

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[2] We say "at least" because Staff's figure does not include the 25 basis point increase in authorized return on equity and reversal of the entire net benefits disallowance, both of which PGE recommends.

[3] For PGE's figures, *see* PGE/6200, Tinker-Schue-Hager/30-34. For Staff's figure, see Staff/102, Busch-Johnson/3 (column A, row 15).

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Second, under the PGE one-year recovery approach, at the time of the UM 989 settlement, customers would have owed PGE approximately $198 million instead of the $180 million Trojan balance that was used to offset about $161 million in customer credits. (PGE/6200, Tinker-Schue-Hager/30.) Under Staff's alternative, customers would owe at least $158.9 million at the time of the UM 989 settlement.[4] (Staff/102, Busch-Johnson/3.) PGE's 17-year recovery alternative yields a customer debt of about $275 million at the time of the UM 989 settlement. (PGE/6200, Tinker-Schue-Hager/34.) While the UM 989 settlement will be examined in more detail in a later phase in this proceeding, these financial impacts show that the range of reasonable UE 88 rates place PGE's balance sheet in roughly the same posture as of the date of the order approving the UM 989 settlement and suggests that customers received substantial economic benefit from the UM 989 settlement.

V. BUILDING BLOCKS

In its testimony, PGE analyzed various building blocks the Commission should consider and suggested how the Commission might have rebalanced them in order to allow PGE a full return of its prudent investment in Trojan while maintaining stable and equitable rates for customers. The following subsections discuss each of the building blocks.

A. RECOVERY PERIOD

In light of the Commission's decision that PGE was entitled to a return of the full amount of its prudent investment in Trojan, which the Court of Appeals affirmed, the Commission should have allowed PGE to recover its investment in as short a period as was feasible. The 17-year recovery period decided upon by the Commission in UE 88 was fair only because PGE was allowed a return to compensate for the delayed recovery of its funds. By "fair" in this context, we mean achieving the overarching goal of setting rates that further

[4] Again we say "at least" because Staff's figure does not include the 25-basis point increase in authorized return on equity and reversal of the entire net benefits disallowance, both of which PGE recommends. *See* pages 8-9 above.

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the goals of safe, reliable utility service to customers, preserving the financial integrity of the utility, and ensuring that utilities continue to make resource decisions that benefit customers and achieve intergenerational equity among customers. (*See* PGE/6000, Lesh/14-15.)

Leaving the recovery period at 17 years without a return would be equivalent to an initial disallowance of $182 million (PGE/6000, Lesh/20; PGE/6200, Tinker-Schue-Hager/16), which would be contrary to the Commission's purpose of allowing PGE to recover the full amount of its prudent investment and the Court of Appeals' twin requirements—(1) PGE should be permitted to recover the undepreciated investment balance of Trojan; and (2) there should be no return on component for retired plant. Moreover, a 17-year recovery period is inconsistent with the objective of ensuring that utilities continue to make least-cost resource decisions. Spreading recovery over 17 years would have resulted in an immediate write down of PGE's undepreciated investment in Trojan without any finding of imprudence or violation of least-cost planning principles to support it. (PGE/6000, Lesh/44.) Unless the Commission can allow PGE the time value of amounts received over time, spreading recovery over time will result in rates that do not meet the objectives the Commission must meet with respect to investors or least cost principles, even if such spreading may meet the objectives of intergenerational equity and rate stability. *Id.*

The Court of Appeals expressly declined to address whether PGE could recover its remaining investment in Trojan immediately rather than over time. *CUB*, 154 Or App at 712 n.5. The Commission noted in UM 989 that it has the authority to prescribe the accounting treatment for public utilities, including the authority to prescribe amortization periods for assets, pursuant to ORS 757.105 to ORS 757.140. UM 989, Order No. 02-227 (March 25, 2003), at 12-13. Thus, the Commission concluded in UM 989 that it "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 . . ." *Id.* at 10-11.

Therefore, PGE recommends, and Staff agrees, that the Commission should have granted PGE recovery of its remaining investment in Trojan expeditiously so as to minimize erosion of the value of PGE's investment and further least-cost planning principles. (PGE/6000, Lesh/20-22; Staff/100, Busch-Johnson/6-8; PGE/6800, Lesh-Hager/2.) As Staff testified:

> We expect the Commission, in revisiting its UE 88 decision, would have allowed 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.

(Staff/100, Busch-Johnson/8.) A longer recovery period would impose a substantial disallowance. Disallowances may be warranted where the Commission finds imprudence, but disallowances are not appropriate if a plant was retired because it was no longer economic to operate.

The period of recovery that both PGE and Staff propose is one year. However, even a delay of one year would reduce the present value of PGE's investment. Accordingly, the Commission should recognize this delay as a benefit to customers when it reconsiders the net benefits test for the closure of Trojan.

B. NET BENEFITS TEST

The Court of Appeals' decision that the Commission may not allow any return on PGE's investment in Trojan alters the Commission's net benefits analysis of whether customers benefit from closing Trojan. Customers enjoy a net benefit in the closure scenario that increases with every year that PGE's return of its investment is deferred. PGE recommends that the Commission recalculate the net benefits test in UE 88, taking these cost savings into account:

> Whether amortization of the undepreciated balance is over one year or 17 years, excluding any return on investment effectively reduces the cost to customers and thus increases the benefit of closure. All else being equal, this will lower the cost

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> of the replacement resources side of the net benefits test, increasing the net benefits to closure. The PGE panel calculates that adjusting the net benefits test for the Court of Appeals' interpretation results in a net benefit for closure of negative $4 million, assuming a one-year amortization period, and $155 million, assuming a 17-year amortization period. This adjustment is consistent with and required by the Commission's methodology.

(PGE/6000, Lesh/26.)

The Commission disallowed recovery of $26.8 million (before taxes) on the basis of the test in UE 88. (PGE/6200, Tinker-Schue-Hager/14.) The value to customers of a one-year delay in PGE's recovery of its Trojan investment is $23 million. (PGE/6200, Tinker-Schue-Hager/16.) This amount will be less if the Commission treats some of the Trojan balance as plant-in-service rather than as abandoned. If the Commission decides that $80 million of Trojan remained as plant-in-service, then the value to customers of a one-year delay in recovery of the remainder of PGE's investment in Trojan is $17.66 million. (Staff/100, Busch-Johnson/19 ("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 a one-year period"). PGE recommends, and Staff agrees, that the Commission should reverse part of its initial disallowance in UE 88 accordingly.

PGE also recommends that the Commission reconsider its determination to exclude all of PGE's projected cost of replacing Trojan's steam generators from the total cost of continued operation for purposes of the net benefits test. (PGE/6000, Lesh/26-28; PGE/6800, Lesh-Hager/5-6.) The Commission found that PGE acted prudently with respect to the purchase and maintenance of the steam generators. Order No. 95-322, at 3. Ordinarily, the Commission allows utilities to recover their prudently-incurred costs. The Commission's decision to exclude the *entire* cost of replacing Trojan's steam generators from PGE's cost of continued operation was an exceptional exercise of the Commission's

discretion. It was not the only "right" way to resolve this issue. The Commission made this decision in the context of the UE 88 rate-making proceeding as a whole, and the Commission is free to reconsider its decision in light of its rebalancing of the relevant factors in this proceeding to achieve an overall fair result. As Ms. Lesh testified:

> We suggest here that, had the Commission known that the Court of Appeals would interpret ORS 757.355 to prohibit rates that included a return on the remaining Trojan investment, the Commission might not have exercised its discretion on this issue as it did. It might not have found it "fair" to allocate this cost to shareholders. No convention dictated the original result and none inhibits a different decision now. Indeed, good regulatory policy supports reversing this UE 88 decision.

(PGE/6000, Lesh/27.)

While Staff does not concur with PGE's proposal regarding steam generators, Staff does acknowledge that the Commission has authority to exercise its discretion with respect to this factor differently than it did before. (Staff/300, Busch-Johnson/4.)[5] The Commission must reconsider all aspects of its ratemaking in UE 88 that are affected by the Court of Appeals' statutory interpretation. (Scope Order at 5.) Because the Commission must revisit its net benefits analysis for the closing of Trojan to take into account the effect of the Court of Appeals' ruling, the Commission should assure itself that its net benefits analysis as a whole is fair and results in fair rates. The Commission may determine that it would not be fair to disallow the entire cost of replacing the steam generators, without any finding of imprudence, particularly if the Commission must delay PGE's recovery of its prudent investment in Trojan. Staff expresses concern that the Commission's reconsideration of its decision regarding the steam generators might "circumvent ORS 757.355." (Staff/300, Busch-Johnson/4.) This concern is unwarranted. ORS 757.355 does not control the

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[5] Staff initially disagreed with PGE's proposal with respect to the steam generator costs, in part because Staff believed that PGE made no efforts to pursue remedies against Westinghouse for the faulty generators (Staff/100, Busch-Johnson/20), which was not correct (PGE/6800, Lesh-Hager/6).

Commission's determination of what costs it would have allowed PGE to recover had Trojan remained in operation. ORS 757.355 applies only to plant that is not in-service, which by definition is not the case under the "continued operation" scenario and the net benefits test.

PGE suggests that the Commission find that it is fair to include all, or at least part, of the prudent cost of replacing Trojan's steam generators in the cost of continued operation of Trojan for purposes of the net benefits test. Including the entire prudent cost increases the benefits of closure by $183 million, resulting in a large positive net benefit (assuming a one-year recovery period). (PGE/6200, Tinker-Schue-Hager/16-17.) This results in a substantial benefit to customers from the shutdown of Trojan and justifies reversal of the entire $26.8 million disallowed in UE 88 on the basis of the net benefits test. (PGE/6000, Lesh/29-31.) [6] Including even a small fraction of the prudent costs for the steam generators would still result in a positive net benefit and justify reversal of the disallowance.

C. PLANT-IN-SERVICE

In its original decision in UE 88, the Commission determined that the accounting classification of Trojan assets to be used for safety, environmental protection and decommissioning would have no effect on rates, and for that reason the Commission classified these assets as abandoned rather than as plant-in-service. Order No. 95-322, at 53. The Court of Appeals' decision undermines the basis for the Commission's resolution of this issue, and therefore the Commission should reconsider the proper accounting classification of Trojan assets. As Ms. Lesh recommended:

> The Commission should revisit its decision regarding the classification of Trojan assets betweens plant-in service and unrecovered plant because, as with its decision regarding amortization period for undepreciated Trojan investment, it relied on the assumption that it could allow PGE to recover its

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[6] PGE also recommends that the Commission consider allowing PGE to share 20 percent of the savings, especially if the recovery period for Trojan were to remain 17 years. (PGE/6000, Lesh/29-31; PGE/6200, Tinker-Schue-Hager/19-20.)

> cost of capital regardless in which account PGE recorded the assets. In other words, as the law stood when the Commission made this decision in UE 88, the decision made no practical difference.

(PGE/6000, Lesh/31.)

PGE recommends, and Staff agrees, that the Commission should find that $80 million in undepreciated Trojan investment remained in utility service following the closure decision. (PGE/6000, Lesh/31-32; PGE/6200, Tinker-Schue-Hager/22; PGE/6300, Quennoz-Peterson-Dahlgren/1-8; Staff/100, Busch-Johnson/16-17; PGE/6800, Lesh-Hager/21-22.) [7] As the PGE Panel of Quennoz-Peterson-Dahlgren testified:

> Q. Was Trojan abandoned in 1995?
>
> A. No. The plant was far from abandoned in 1995 because it was in the early stages of a long and complicated decommissioning process. Further, neither Staff nor the Commission explicitly disagreed with PGE's method to identify Trojan plant in service. In fact, Staff audited PGE's analysis and work papers and their testimony took no exception to our results. Ultimately, the Commission agreed that the referenced assets were providing service (OPUC Order No. 95-322, p. 53).
>
> Q. Are these assets necessary to protect the public health and safety?
>
> A. Yes. These assets provide necessary service, required both before the Trojan plant was shut down and during the commissioning.

(PGE/6300, Quennoz-Peterson-Dahlgren/5.) Staff witnesses agreed:

> We agree with classification of $80.2 million of Trojan investment as plant in service . . . There are several reasons that support classification of a portion of Trojan investment as plant in service. 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

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[7] The $80 million figure is a net number. The gross figure is $130 million. (PGE/6300, Quennoz-Peterson-Dahlgren/6.)

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> 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.

(Staff/100, Busch-Johnson/16.)

URP argues that protection of public safety during decommissioning is not a "utility service" (URP/204, Meek/15-16), but that argument reflects an unduly limited interpretation of the services a utility should provide to the public. ORS 757.355 permits the Commission to include in rate base property "presently used for providing utility service to the customer." In *CUB*, the Court of Appeals found that this statute expresses a traditional rate-making principle and does not impose a new form of restraint. 154 Or App at 710. The definition of "service" is found in ORS 756.010(8): "'Service is used in its broadest and most inclusive sense and includes equipment and facilities related to providing the service or the product served." In PGE's Opening Brief, we cited decisions in Oregon and other states illustrating how broadly utility "service" is interpreted. (PGE's Opening Brief at 13-14.)[8] Consistent with that broad interpretation, the Commission should reconsider its classification of Trojan assets in UE 88 and find that $80 million of assets remained in service for safety, environmental protection and decommissioning.

In 1994, PGE presented evidence to support inclusion of $80 million of Trojan assets in plant-in-service.[9] (PGE/2000, Marold/69-71.) FERC approved PGE's

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8 *Northwest Climate Conditioning Ass'n v. Lobdell*, 79 Or App 560, 565 (1986); *In re Pacific Northwest Bell Tel. Co.*, 110 PUR 4th 132, 1989 WL 418536 (OPUC Dec. 29, 1989); *Bookstaber v. PECO Energy Co.*, 2004 WL 2983032 (Pa. PUC Nov. 23, 2004); *In Re Gulf Power Co.*, 218 PUR 4th 205, 2002 WL 1349501 (Fla. PSC June 10, 2002); *West Penn Power Co. v. Pa. PUC*, 578 A2d 75, 76 (Pa. Commw. Ct. 1990).

9 PGE's analysis of its actual use of Trojan assets following UE 88 would support the inclusion of $113.6 million of Trojan assets in plant-in-service. (PGE/6300, Quennoz-Peterson-Dahlgren/6-7; PGE/6303, Quennoz-Peterson-Dahlgren/1-18.) However, PGE's evidence in UE 88 supported the $80 million figure, and PGE does not request that the Commission approve a higher amount.

classification of those assets within Account 101, Plant-in-service. (PGE/6301, Quennoz-Peterson-Dahlgren/1-9.) Neither Staff nor the Commission disagreed with PGE's methodology, and in fact the Commission acknowledged that the assets "provide the service necessary for safety and asset preservation pending decommissioning and dismantling of the plant." Order No. 95-322 at 53. Thus the Commission implicitly recognized that these assets were not in fact abandoned. PGE requests that, in light of the Court of Appeals' decision that "abandoned" assets may not be included in rate base and earn a return, the Commission reconsider its classification of Trojan assets that remained in use to serve the public interest and allow $80 million of assets to remain in the plant-in-service category.

D. BALANCE SHEET OPTIONS

PGE's balance sheet at the time of UE 88 included a customer credit of $111 million from the sale of a portion of Boardman, which was being amortized over a 27-year period ending in 2013. PGE recommends that the Commission conclude that it would have offset the remaining Boardman credit against an equal amount of undepreciated Trojan investment, and Staff agrees with this proposal. (PGE/6000, Lesh/33-35; PGE/6200, Tinker-Schue-Hager/23-24; Staff/100, Busch-Johnson/18.)

This offsetting of balance sheet entries would have served several beneficial purposes. First, it would have lessened PGE's loss from the delayed recovery of its prudent investment in Trojan, whether that recovery takes place over one year or over a longer period. Second, if PGE did recover its investment in Trojan over a relatively short period such as one year, the offset would have reduced the impact on customers and kept rates stable. Finally, the offset would have served the goal of intergenerational equity among customers, because both the Boardman sale and the Trojan closure affected customers over a long period, not just in the short term. Staff witnesses concur:

> It would be reasonable to reduce the remaining Trojan investment by the amount of the Boardman gain because it

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Portland, Oregon 97204
503-221-1440

> would improve the matching of costs and benefits among generation of customers, as well 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 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.

(Staff/100, Busch-Johnson/18.)

The Commission has broad authority to prescribe accounting rules for recovery and depreciation, and the Commission exercised that authority by using the offset principle in UM 989 and UE 93 when it was in the interests of customers and the utility. See, *e.g.*, UM 989, Order No. 02-227 (March 25, 2002), at 12-13, *citing* ORS 757.105 to 140; UE 93, Order No. 95-1216 (Nov. 20, 1995), Appendix B.[10] The Commission should use the offset principle in this proceeding to facilitate PGE's recovery of its investment in Trojan in a manner that is fair to PGE and customers.

Another balance sheet option that the Commission may consider is deferring a portion of UE 88 test year power costs. (PGE/6000, Lesh/35-37; PGE/6200, Tinker-Schue-Hager/25). This deferral may be appropriate to stabilize rates if the Commission authorizes recovery of the Trojan balance in one year. ORS 757.259(2)(e) authorizes deferred accounting for "identifiable utility expenses or revenues, the recovery or refund of which the Commission finds should be deferred in order to minimize the frequency of rate changes or the fluctuation of rate levels or to match appropriately the costs borne by and benefits received by ratepayers." Because a rapid recovery of the Trojan balance would cause a significant and short-term rise in rates, the Commission may exercise its discretion to defer

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[10] Using the Boardman gain as an offset against the Trojan balance in UE 88 would have changed the options available to the Commission in UE 93. In that proceeding, the Commission decided to offset the Boardman gain against the unamortized balance of the power cost deferrals previously authorized in UM 529, UM 594 and UM 692, the AMAX deferral approved in UE 79, the SAVE incentive, and a portion of the unamortized Trojan investment. (PGE/6000, Lesh/33-35; PGE/6200, Tinker-Schue-Hager/23-24.)

some power costs in order to smooth rates. (PGE/6000, Lesh/35-36: "If the Commission decided, on remand, that PGE should amortize its Trojan investment over one year, the total revenue requirement of current power costs and Trojan recovery would be temporarily high. In these circumstances, deferring a portion of current 1995 power costs for recovery in subsequent years would simultaneously improve the matching of the costs and benefits of the Trojan closure decision and increase rate stability.")

While Staff does not include such a deferral in its proposed alternatives, Staff acknowledges that the Commission could exercise its discretion to defer power costs. (Staff/100, Busch-Johnson/18.) PGE generally supports Staff's alternative, which eliminates the 1995 and 1996 power cost deferrals as providing a reasonable alternative. (PGE/6800, Lesh-Hager/4.) PGE disagrees with certain aspects of Staff's alternative, particularly its position on the replacement steam generators, but supports Staff's overall approach.

E. RETURN ON EQUITY AND CAPITAL STRUCTURE

In 1994, PGE offered evidence that PGE's required return on equity ("ROE") was in the range of 11.46 percent to 13.37 percent, and PGE stipulated with Staff to an ROE toward the bottom of the range, at 11.6 percent, which was approved by the Commission. (PGE/6400, Hager 7-10.) The stipulation also established PGE's capital structure. *Id.* PGE's evidence on its required ROE and PGE's willingness to enter into the stipulation relied on the assumption that the Commission would allow PGE to recover its remaining investment in Trojan over time with a return. (PGE/6400, Hager/12; PGE/6800, Lesh-Hager/3-4, 9.) Now that the Court of Appeals has reversed this fundamental assumption, it is appropriate to reconsider what ROE and capital structure the Commission should have established for PGE in UE 88. As Ms. Lesh observed:

> I base this policy view on the inherently uncertain nature of determining now—over ten years later—what the Commission would have decided in UE 88. Likewise, we are hesitant now to conclude that PGE would have stipulated to the same

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Portland, Oregon 97204
503-221-1440

> revenue requirement elements to which we stipulated in UE 88. For example, PGE stipulated in UE 88 to the return on common equity of 11.6 percent. Had we known of the Court of Appeals' ruling, we might not have agreed to this number. We might have refused to stipulate for less than a higher amount, say 11.8 percent.

(PGE/6800, Lesh-Hager/3-4.)

The Court of Appeals' determination that a utility in Oregon may not earn a return on its investment in a plant that was retired from service earlier than anticipated for economic reasons sets Oregon apart from other jurisdictions. It is to be expected that investors in Oregon utilities would take this regulatory shift into account when assessing the return they expect to earn on their prudently-managed investments. (PGE/6500, Makholm/1-34; PGE/6600, Blaydon/1-15; PGE/6700, Hess/1-8; PGE/7000, Blaydon/1-8.)

> I conclude that the Court of Appeals' interpretation, disallowing any return on the undepreciated balance of a utility plant that is retired for economic reasons, increases the required rate of return that investors demand for investing in the Oregon utilities. Given the uniqueness of this new regulatory regime in the U.S., investors are likely to view Oregon utilities as above average risks relative to other utilities elsewhere in the U.S. Based on my analysis, PGE's proposed return on equity (ROE) of 13.1 percent is reasonable because it falls within the range of estimated ROEs for electric utilities with above average returns.

(PGE/6600, Blaydon/1.)

> I conclude that investors will demand a large return for Oregon utility investments because of this anomaly from the expected regulatory compact arising from this particular interpretation of Oregon law.

(PGE/6500, Makholm/3.)

PGE recommends that the Commission raise PGE's required ROE for UE 88 between 25 and 150 basis points, depending on the degree to which the Commission delays PGE's recovery of its investment in Trojan. (PGE/6000, Lesh/23-24; PGE/6400, Hager/18-25.) As an alternative, PGE recommends that the Commission use a hypothetical capital structure with greater amounts of equity to set PGE's rates, which would have the

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

same effect as the proposed change in ROE. (PGE/6000, Lesh/24-25.)

Staff agrees that, if the Commission were to delay substantially PGE's recovery of its investment in Trojan without granting any return, the Commission could compensate for the financial impact on PGE by adjusting PGE's capital structure or ROE. (Staff/100, Busch-Johnson/22; Staff/200, Morgan/25.) However, given Staff's expectation that the Commission will allow PGE to recover its investment in Trojan promptly, Staff concluded that cost of capital is not a key element of this case. (Staff/200, Morgan/24.)

PGE agrees that cost of capital is not a large factor if PGE's Trojan balance is returned within one year; however, PGE does not agree with Staff's conclusion that it is negligible. (PGE/6800, Lesh-Hager/7-10.) Staff's conclusion that there would be no cost of capital effects in the one-year scenario is based on the assumption that the one-year delay in PGE's recovery of its investment would be a "short-term, nonrecurring" event. (Staff/200, Morgan/4, 24-25.) This assumption is faulty, because the retirement of a utility asset before the end of its predicted lifespan is not a unique event but rather is one that can be expected to recur. The Commission's decision on how to permit PGE to recover its investment in Trojan signals how the Commission may deal with future plant retirements. Thus, while a one-year delay of the recovery of PGE's investment in Trojan without a return will have substantially less financial impact than a 17-year delay without a return, it nonetheless has a measurable impact, which can be expected to recur when other assets are retired. Therefore, PGE suggests that if the Commission finds that PGE should have recovered its investment in Trojan over one year, the Commission should consider a modest increase in PGE's ROE of 25 basis points.

> Whether investors in 1995 would have demanded a slightly higher return on PGE's equity would depend on whether they believed that they were adequately compensated by the Commission and what they believed the Commission would do in a similar situation in the future. Even if investors received their principal, however, they would incur reinvestment

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> risk/the risk that they would not be able to invest their proceeds at the original, and higher, rate of return. Thus, rational investors would demand a slightly higher return. But, again, we note that Staff and PGE agree that the cost of capital effect would be small. Staff believes it would be 0. PGE believes it would be about 25 basis points.

(PGE/6800, Lesh-Hager/9.)

F. DEBT COSTS FOR TROJAN INVESTMENT

Another building block that PGE offers for the Commission's consideration is providing for recovery of PGE's debt costs for Trojan, while not allowing any profit to PGE's investors. (PGE/6000, Lesh/37-38; PGE/6800, Lesh-Hager/6.) PGE presents this option as an alternative to its principal proposals. Allowing for recovery of debt costs that PGE had already incurred prior to UE 88 and that PGE was obligated to repay would be consistent with the Court of Appeals' interpretation of ORS 757.355. That statute prohibits the inclusion of certain property in "rate base." In its opinion, the Court of Appeals repeatedly equated the concept of return on property in rate base with "profit." 154 Or App at 706, 713, 714. PGE does not recommend that the Commission include the Trojan balance in rate base or allow any profit on that balance. Instead, PGE suggests that the Commission may recognize the specific amounts that PGE was obligated to repay for its Trojan-related debt and include those amounts in setting PGE's revenue requirement. As discussed in PGE's Opening Brief, there is precedent for treating debt costs and profit separately for retired utility assets. (PGE's Opening Brief at 16-17.)

Staff and URP do not concur in PGE's interpretation of the Court of Appeals' decision. (Staff/100, Busch-Johnson/25; Staff/200, Morgan/4; Staff/300, Busch-Johnson/5; URP/400, Meek/8.) Staff expresses the view that neither a return on equity nor interest on debt is truly "profit." (Staff/200, Morgan/4.) But the Court of Appeals repeatedly used the term "profit" to express its understanding of what ORS 757.355 355 prohibits. Shareholders, not lenders, receive profits. The Commission has discretion consistent with the Court of

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888 SW Fifth Avenue, Suite 1600
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Appeals' decision to allow PGE to recover sufficient funds to meet its debt obligations for Trojan.

VI. URP'S AND CLASS ACTION PLAINTIFFS' ARGUMENTS

The bulk of the opposition argument and testimony filed on behalf of URP and the Class Action Plaintiffs (collectively, URP) is at odds with the fundamental nature of ratemaking or inappropriate for the Commission's consideration in this proceeding. URP takes the position that the Commission should eliminate the return on Trojan without giving any attention to how that change would affect the other elements that the Commission considered in its effort to set fair rates in UE 88. This approach is improper in a rate-making proceeding. URP also urges the Commission to consider events that took place after 1995 in deciding what rates it would have set in UE 88, which is improper as well.

A. ISOLATING THE RETURN ON TROJAN

URP blatantly disregards the Commission's determination that its task in this proceeding is to engage in ratemaking and determine "what rates would have been approved in UE 88" had the Commission known that it could not allow a return on PGE's undepreciated investment in Trojan if it delayed recovery. (Scope Order at 5.) Instead, URP performs a computation of a refund amount based on the rates that the Commission approved in UE 88 before it had the benefit of the Court of Appeals' ruling. (URP/200, Lazar/1-2; URP/204, Meek/1.)[11] In justification for this narrow approach, URP argues that the Commission should function in a manner identical to a trial court. (URP/204, Meek/5-8.) There are the same arguments URP made, the ALJ and Commission rejected, during the

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[11] The ALJ ruling dated September 19, 2005, declined to include Mr. Meek's testimony in the record but allowed Mr. Meek to renew these arguments in briefing and permitted the Commission to consider Mr. Meek's testimony as comments. We respond to Mr. Meek's arguments in the expectation that URP will urge them in briefs and to provide the Commission with PGE's response in the event the Commission exercises its discretion to consider Mr. Meek's testimony as comments.

scoping phase of this proceeding. (*See*, *e.g.*, Scope Order at 2-3.) The Commission's role is not as limited as URP contends.

The Commission's fundamental task in a rate-making proceeding is to establish "just and reasonable" rates pursuant to ORS 757.020. (Scope Order at 6.) In doing so, it considers and resolves various issues to reach a result that is fair to the utility and to customers. PGE's testimony describes three criteria that reflect sound regulatory policy and that may be used to guide rate-making decisions. (PGE/6000, Lesh/14.) A rate decision consists of interconnected factual and policy elements, and it is the end result, not the components, that the Commission ultimately decides is "just and reasonable." In reconsidering its decision in UE 88 to take into account the Court of Appeals' interpretation of the law, the Commission must continue to fulfill its obligations under its general powers authority (ORS 756.040) and its specific rate-making power (ORS 757.210 and ORS 757.020).

In UE 88, the Commission decided that it would be appropriate to delay PGE's recovery of its prudent investment in Trojan over 17 years while allowing PGE to earn a return on its undepreciated balance over that time. Had the Commission known that it could not allow a return on the undepreciated balance, it likely would have considered alternative approaches to achieve a fair result. Neither the Commission nor the Court of Appeals decided that it would be just and reasonable to delay PGE's recovery of its investment in Trojan over 17 years without any return.

Even if the Commission's task in this proceeding were to remove the "return on" from its UE 88 rates while holding all other elements constant, it still would be impossible to correlate the "return on" element with any amount in the actual rates charged for usage by customers. After establishing a utility's revenue requirement, the Commission engages in sophisticated processes to determine rate spread and rate design. The costs

included within revenue requirement have no direct correlation to the rates ultimately set for various types of electricity usage. Moreover, actual costs and revenues always vary from forecasted costs and revenues. (PGE/6100, Dahlgren/8-12.)

B. DEFERRED TAXES AND CAPITAL STRUCTURE

Mr. Lazar testifies that customers are entitled to the accumulated deferred taxes associated with Trojan and an adjustment to PGE's capital structure. (URP/200, Lazar/5-10.) Mr. Lazar's proposed capital structure adjustment results in a $106 million increase in URP's refund claim, and his accumulated deferred tax theory would result in a $83 million customer credit. *Id.* at 8, 9. Both theories are fundamentally flawed. They rely on the mistaken assumption that the Commission would require a complete write-off of the undepreciated investment in Trojan. This assumption is inconsistent with generally accepted accounting principles and with the Court of Appeals' decisions, which ruled that PGE could recover its investment in Trojan. As the PGE Panel testified:

> Again Mr. Lazar's error is that he assumes a full write off is required in this case. Since this assumption is not correct, his 'adjustment' to the capital structure is inappropriate. Even if the Commission had only allowed PGE to collect the outstanding balance of Trojan over a period of almost 17 years, with no return, accounting rules would not require a full write-off. The collecting of approximately $340 million over 17 years has a net present value of considerably less than $340, but much greater than zero.

(PGE/6900, Hager-Tinker-Schue/7.)

C. POST-1995 EVENTS

URP urges the Commission to consider several events that occurred after 1995 and that, therefore, the Commission could not have considered in UE 88: PGE's earnings from 1995 to 2000, Enron's purchase of PGE in 1997, and the income tax effects of Enron's ownership of PGE. (URP/204, Meek/9-14; URP/400, Meek/1.) Consideration of these post-1995 events is improper, because the Commission's task in this proceeding is to

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determine "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." The new interpretation of ORS 757.355 likely would have led the Commission to consider the information available to it in 1995 differently, but the Commission could not have considered future events when setting rates in UE 88. Therefore, in determining what rates it would have set in UE 88, the Commission should disregard URP's testimony and arguments relating to post-1995 events. As the ALJ's Ruling striking portions of Mr. Meek's testimony concluded:

> Contrary to URP's assertion, this proceeding does not allow any party to present factual evidence that could not have been presented in the original proceeding. While the Commission must now apply a different legal interpretation of ORS 757.355, the factual evidence to which that statute is applied must encompass the same timeframe, that is, information that could have been presented during UE 88.

(ALJ Ruling dated July 25, 2005.)

1. Earnings

Even if it were proper for the Commission to consider post-1995 events, URP's testimony still would be irrelevant to the determination of rates in UE 88. With respect to PGE's earnings, it is inherent in utility rate regulation that actual conditions affecting costs and revenues will vary from the test year conditions on which rates are based, and neither the utility nor its customers can recover for these fluctuations. (PGE/6800, Lesh-Hager/12, 17.) While PGE's earnings may have been higher than expected for a few years following UE 88, PGE's earnings were lower than expected in subsequent years. (PGE/6800, Lesh-Hager/12.)

> The Commission sets rates so that a utility has an opportunity "on average" to earn its authorized return on equity. Sometimes the utility earns more than its expected return on equity; sometimes it earns less. Earnings in any particular year depend on many factors, particularly hydro conditions and market gas and electric prices. In fact, some of these and other

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Portland, Oregon 97204
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> factors combine so that PGE earned less than its authorized return on equity in the years 1999 through 2003.

(PGE/6800, Lesh-Hager/12.)

2. Enron Acquisition

As for Enron's acquisition of PGE, the price paid by Enron to Portland General Corporation's ("PGC") stockholders does not bear on any issue relevant to a rate-making proceeding. Gains and losses on stock sales are not recognized in ratemaking, nor are changes in the market value of assets.

> Gains or losses on stock sales are not recognized in ratemaking. Rates are set based on the original cost of assets adjusted for accumulated depreciation. Changes in market value as represented by increases and decreases in stock prices are not reflected in rates.

(PGE/6800, Lesh-Hager/17.)

3. Income Taxes

Finally, with respect to PGE's income taxes, PGE accounted for its taxes following its acquisition by Enron in accordance with well-established Commission policies. (PGE/6800, Lesh-Hager/17-18 ("[The stand alone approach was] well established rate-making policy of the Commission when its set rates in UE 88. PGE had been consolidated for tax purposes with its then parent, Portland General Corporation (PGC") since 1986. The Commissioner approved PGC's acquisition of PGE in Order No. 86-106, entered January 31, 1986."))

The Commission Staff's White Paper ("Treatment of Income Taxes in Utility Rate Making," dated February 2005) was an authoritative examination of how consolidated taxes should be accounted for. It concluded that Oregon has used the stand-alone approach. Staff White Paper at 1 ("Most states, including Oregon, use the traditional 'stand-alone' method for calculating the amount of income taxes to be incorporated into a regulated utility company's rates.") In March 2005, the Commission made recommendations to the Oregon

legislature regarding the treatment of utility income taxes. In that report, it recognized that "today, we set the utility's rates on a stand-alone basis." There is no reason to believe the Commission would have taken a different view in 1995. The Court of Appeals' decision in CUB has no bearing on this issue.

In summary, none of the post-1995 events upon which URP dwells would have had any relevance to the Commission's ratemaking in UE 88 even if they had been known then.

VII. RELEVANT PERIOD

The issue in this phase of the proceeding is limited to what the Commission would have approved in UE 88 had it interpreted ORS 757.355 the way the Court of Appeals did. (Scope Order at 5.) Thus, the only rate-making proceeding that the Commission must reconsider is UE 88. The rates subsequently set in UE 93 and UE 100 need not be reconsidered in this phase, nor need they be reconsidered in this proceeding at all. As discussed in PGE's Opening Brief, those rates were not appealed and therefore they become conclusively final 60 days after the Commission set them. ORS 756.565, 756.580. (PGE's Opening Brief at 20-23.)

While there is no legal basis to change the rates set in UE 93 and UE 100, PGE's analytical work extends through the period that those rates were in effect for two reasons. First, in analyzing the UM 989 settlement, which will be the subject of a later phase, it is helpful to show what the financial impact over time would have been of different rate decisions in UE 88. The Commission's decision in UE 88 set in motion certain accounting and financial consequences, and the UM 989 remand instructed the Commission to consider those consequences when assessing the UM 989 settlement. Second, in the interest of efficiency, PGE suggests that the Commission make findings about how any change in UE 88 rates would have affected rates set in UE 93 and UE 100. Then, if the

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

courts should rule on appeal that the rates in those proceedings may be modified, even though they were not appealed, the Commission and the parties will not need to resubmit evidence.

The settlement in UM 989 will be an issue for a later phase of this proceeding, after the Commission determines what rates it would have set in UE 88. (Scope Order at 6.) Therefore, the Commission need not make any findings in this phase with respect to testimony offered by the parties that solely concerns the UM 989 settlement. (*See, e.g.*, URP/200, Lazar/2, 13.)

URP also offers some testimony about rates that were in effect in 1992-1995. (*See, e.g.*, URP/200, Lazar/2, 13.) There is no basis whatsoever for the Commission to reconsider rates set in proceedings prior to UE 88. The Court of Appeals' decision has no bearing on rates that were set by the Commission while Trojan was still operating. Testimony regarding the rates in effect in 1992-1995 IS beyond the scope of this phase of the docket, which requires an "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." (Scope Order at 5-6.)

VIII. CONCLUSION

The evidence in this docket establishes a range of reasonable UE 88 rates. Both Staff and PGE have presented reasonable rate-making alternatives that establish just and reasonable UE 88 rates, further important Commission policies and satisfy the criteria PGE proposes, and comply with the remand orders in DR 10, UE 88 and UM 989. The evidence also shows that the range of reasonable UE 88 rates is higher than PGE's actual UE 88 rates, demonstrating that the end result in UE 88 was just and reasonable rates. The evidence also bears directly on the UM 989 settlement. It shows that the range of reasonable UE 88 rates results in a PGE balance sheet substantially similar to PGE's actual balance at

the time of the UM 989 settlement. The $180 million Trojan balance that PGE and the Commission used to offset against customer credits is replaced with regulatory assets of between $198 million (PGE's one-year recovery alternative), more than $158 million (Staff's alternative), or $275 million (PGE's 17-year recovery). While the Commission will consider the UM 989 settlement in greater detail later, this range of reasonable outcomes suggests that the Commission's approval of UM 989 settlement was reasonable and that customers received a substantial benefit as result of that settlement.

PGE recommends that the Commission enter a final order adopting these recommendations and financial impacts as further set forth in the attached proposed final order (Ex. 1).

DATED this 9th day of November, 2005.

PORTLAND GENERAL ELECTRIC COMPANY

J. Jeffrey Dudley, OSB No. 89042
121 SW Salmon Street, 1WTC1300
Portland, OR 97204
Telephone: 503-464-8926
Fax: 503-464-2200
E-Mail jay.dudley@pgn.com

TONKON TORP LLP

Jeanne M. Chamberlain, OSB No. 85169
Direct Dial 503-802-2031
Direct Fax 503-972-3731
E-Mail jeanne@tonkon.com
David F. White, OSB No. 01138
Direct Dial 503-802-2168
Direct Fax 503-972-3868
E-Mail davidw@tonkon.com
888 S.W. Fifth Avenue, Suite 1600
Portland, OR 97204-2099
Of Attorneys for Portland General Electric Company

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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)	**PORTLAND GENERAL ELECTRIC COMPANY'S PROPOSED FINAL ORDER (PHASE I)**

I. PROCEDURAL HISTORY

On March 3, 2004, the Commission issued a notice of consolidated procedural conference to be held on March 18, 2004. On March 9, 2004, the Utility Reform Project ("URP") filed a motion to postpone the procedural conference. On March 11, 2004, ALJ Kirkpatrick issued a ruling postponing the consolidated procedural conference. On March 19, 2004, ALJ Kirkpatrick issued a rescheduled consolidated procedural conference to be held March 31 2004. On March 31, 2004, a consolidated procedural conference was held. On April 1, 2004, ALJ Kirkpatrick issued a consolidated procedural conference memorandum adopting a schedule for the parties to submit simultaneous opening memoranda and reply memoranda.

On March 31, 2004, Linda Williams filed a petition to intervene on behalf of Frank Gearhart, Kafoury Bros., LLP and Patricia Morgan ("Class Action Plaintiffs"). The petition to intervene was corrected on April 16, 2004.

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

On April 1, 2004, ALJ Kirkpatrick issued a memorandum to all current parties in dockets DR 10, UE 88 and UM 989 according to which all parties in these dockets, other than those that appeared at the consolidated pre-hearing conference, must give notice of their plans to participate as parties by April 12, 2004.

On April 16, 2004, PGE, URP and the Class Action Plaintiffs filed opening memoranda regarding the scope of issues to be addressed in this remand proceeding and proposed schedules. On April 16, 2004, a notice of consolidated pre-hearing conference was issued for a consolidated pre-hearing conference to be held on April 27, 2004.

On April 23, 2004, Commission Staff and PGE filed reply memoranda concerning the issues to be addressed in this docket and the procedural schedule. On April 26, 2004, URP filed its reply memorandum.

On April 27, 2004, a consolidated procedural conference was held. The Class Action Plaintiffs' notion to intervene was granted.

On May 5, 2004, ALJ Kirkpatrick issued a ruling asking the parties to address the question: "Should the Commission determine how the court's opinions and the appeals of these cases affect the rate decisions made by the Commission, in their entirety, or whether the Commission's inquiry is more ministerial, and involves only determining the charges customers paid to PGE for interest on PGE's investment in Trojan?" The ruling asked for opening memoranda on June 3, 2004 and simultaneous reply memoranda on June 24, 2004.

On June 3, 2004, Commission Staff, PGE, URP and the Class Action Plaintiffs filed opening memoranda regarding the scope of issues in this proceeding. On June 25, 2004, Commission Staff, PGE, URP and the Class Action Plaintiffs filed reply memoranda.

On August 31, 2004, ALJ Kirkpatrick issued a ruling regarding the scope of Phase I.

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On September 3, 2004, ALJ Kirkpatrick signed Protective Order No. 04-502.

On September 3, 2004, a notice of pre-hearing conference memorandum was issued for a pre-hearing conference to be held on September 24, 2004. On September 13, 2004, URP filed a motion for certification of ALJ Kirkpatrick's August 31 ruling.

On September 16, 2004, ALJ Kirkpatrick issued a ruling postponing the pre-hearing conference scheduled for September 24, 2004.

On September 28, 2004, PGE filed its response to URP's motion for certification. On October 18, 2004, the Commission issued Order No. 04-597 granting certification and affirming ALJ Kirkpatrick's ruling dated August 31, 2004.

On November 9, 2004, a notice of pre-hearing conference was issued for a pre-hearing conference to be held on December 2, 2004.

On December 2, 2004, a consolidated procedural conference was held.

On December 8, 2004, a consolidated procedural conference ruling and memorandum was issued establishing a procedural schedule.

On December 20, 2004, URP and the Class Action Plaintiffs filed an application for reconsideration of Commission Order No. 04-597.

On December 21, 2004, PGE filed a request for extension of time to file a response to the application for reconsideration. On December 22, 2004, ALJ Kirkpatrick granted the request for extension. On January 14, 2005, PGE filed its opposition to the application for reconsideration. On January 18, 2005, Commission Staff filed its response to the application for reconsideration. On January 20, 2005, Commission Staff filed a motion to accept late-filed pleadings, and on January 24, 2005, ALJ Kirkpatrick issued a ruling granting Commission Staff's motion to submit late-filed pleadings.

On February 11, 2005, the Commission issued Order No. 05-091 denying URP's request for reconsideration.

Tonkon Torp LLP
888 SW Fifth Avenue, Suite 1600
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On February 15, 2005, PGE submitted its opening testimony (PGE Ex. Nos. 6000, 6100, 6200, 6300, 6400, 6500, 6600, 6700, and its opening brief) and accompanying exhibits.

On April 18, 2005, URP and the Class Action Plaintiffs filed a motion for a 21-day extension of time to file testimony. On April 20, 2005, a telephone conference was held to address the motion filed by URP and the Class Action Plaintiffs. On April 28, 2005, a consolidated pre-hearing conference was held for the purpose of addressing URP's and the Class Action Plaintiffs' motion to extend the procedural schedule. On May 2, 2005, ALJ Kirkpatrick issued a ruling and consolidated pre-hearing conference memorandum in which a revised procedural schedule was adopted.

On May 19, 2005, URP submitted its opening testimony and exhibits (URP/200-202 and URP/204-205). On May 19, 2005, Commission Staff filed its opening testimony (Staff/100-102 and Staff/200-202).

On June 14, 2005, PGE filed a motion to strike certain portions of Mr. Meek's testimony (URP/204).

On June 27, 2005, PGE filed its rebuttal testimony (PGE Exhibit Nos. 6800, 6900 and 7000), along with accompanying exhibits.

On June 29, 2005, URP filed a motion to compel PGE answers to URP's third discovery request.

On June 29, 2005, URP filed a motion for extension of time to respond to PGE's motion to strike and request to waive the requirement of filing a paper copy. On June 30, 2005, ALJ Grant granted URP's motion for an extension of time and granted URP's waiver of paper filing.

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On July 1, 2005, ALJ Grant issued a ruling revoking the waiver of paper filing requirement and requiring Mr. Meek to file a show cause response as part of URP's July 8, 2005 response to PGE's motion to strike.

On July 8, 2005, URP filed a response to PGE's motion to strike and its response to the July 1 show cause order.

On July 13, 2005, PGE filed an opposition to URP's motion to compel. On July 13, 2005, URP filed a reply in support of its motion to compel. On July 15, 2005, PGE filed a surreply in opposition to URP's motion to compel and a motion to strike or, in the alternative, grant PGE leave to file its surreply.

On July 25, 2005, ALJ Grant issued a ruling granting PGE's motion to strike and denying URP's motion to compel.

On July 25, 2005, URP filed a motion for a three-day extension of time to file surrebuttal testimony. On July 28, 2005, PGE filed a response to URP's motion for an extension of time. On July 28, 2005, ALJ Grant issued a ruling granting URP's motion for an extension of time.

On August 1, 2005, Commission Staff submitted its surrebuttal testimony (Staff/300 and Staff/400-401). On August 1, 2005, URP submitted its surrebuttal testimony (URP/300 and URP/400). On August 1, 2005, the Class Action Plaintiffs submitted a statement sponsoring and adopting the surrebuttal testimony filed on behalf of URP.

On August 16, 2005, cross-examination statements were filed on behalf of Commission Staff, PGE, URP and the Class Action Plaintiffs.

On August 22, 2005, URP and the Class Action Plaintiffs submitted a revised cross-examination statement.

On August 23, 2005, PGE submitted its sursurrebuttal testimony (PGE Ex. No. 7100).

On August 23, 2005, URP filed an emergency motion for clarification and relief from orders of July 25 and August 23, 2005. On August 23, 2005, ALJ Kirkpatrick issued a corrected memorandum regarding cross-examination schedule, affidavits to be filed in place of cross-examination, and compliance of Mr. Meek's testimony with Rule 3.7 of the Oregon Rules of Professional Conduct.

On August 24, 2005, PGE filed a comment on URP's emergency motion for clarification and relief.

On August 25, 2005, PGE filed a motion in limine.

On August 26, 2005, ALJ Kirkpatrick issued a ruling clarifying the prior procedural rulings regarding Mr. Meek's testimony and compliance with Oregon Rules of Professional Conduct, Rule 3.7.

On August 26, 2005, URP filed a notice regarding ALJ Kirkpatrick's clarification.

On August 29 and 30, 2005, a hearing was conducted during which Ms. Williams and Mr. Meek cross-examined PGE witnesses and Commission Staff witnesses. ALJ Kirkpatrick left the record open for certain post-hearing submissions.

On August 31, 2005, URP filed a motion for extension of time to file post-hearing documents. On September 1, 2005, ALJ Kirkpatrick issued a post-hearing memorandum and ruling granting URP's motion for an extension of time to file post-hearing documents. On September 6, 2005, URP filed an affidavit of Jim Lazar adopting pre-filed testimony, a motion to strike certain portions of testimony, and notices and affidavits in support of its request that Mr. Meek be allowed to submit testimony in this docket.

On September 8, 2005, URP submitted an affidavit of Daniel Meek adopting pre-filed testimony.

On September 9, 2005, Commission Staff and PGE filed responses to URP's motion to strike.

On September 19, 2005, ALJ Kirkpatrick issued a ruling closing the record, denying URP's motion to strike, declining to accept the testimony of Mr. Meek into the record, and establishing a briefing schedule.

II. [SUMMARY OF THE PARTIES' POSITIONS]

[INTENTIONALLY LEFT BLANK]

III. COMMISSION ANALYSIS AND DISCUSSION

The Commission concludes that PGE and Staff have presented three alternatives that provide a range of reasonable UE 88 revenue requirements. The three alternatives are PGE's one-year alternative, Staff's one-year alternative as modified according to PGE's recommendations, and PGE's 17-year alternative[1]. UE 88 rates set using these alternatives would have been just and reasonable.

While we conclude that each alternative provides a reasonable UE 88 revenue requirement that is consistent with the remand orders in DR 10, UE 88 and UM 989, the applicable legal standard and the Commission's regulatory policies, we find that PGE's one-year alternative is the preferred approach.

We analyzed the alternatives and their component parts (building blocks) using three regulatory policies or criteria. These three criteria are as follows:

1. Does the alternative encourage electric utilities to analyze and make resource decisions that would yield an adequate and reliable supply of energy at the least-cost to the utility and its customers consistent with the long-run public interest?

2. Does the alternative equitably allocate the costs and benefits of utility resource decisions to customers over time?

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[1] The precise components of each alternative are set forth in the conclusion of this order.

3. Does the alternative preserve the utility's financial integrity and ability to attract debt and equity capital so that it can provide safe, reliable and adequate utility service to customers over time at reasonable rates?

Using these three criteria, we find that the three approaches offered in this docket provide a reasonable range for the UE 88 revenue requirement. In particular, we find that each approach is consistent with providing utilities an incentive to acquire resources consistent with least-cost planning principles. Moreover, we find that all three alternatives reasonably allocate the costs and benefits of PGE's resource decisions to customers over time. Finally, we find that each alternative preserves PGE's financial integrity, permitting PGE to provide adequate, safe and reliable utility service to customers.

While all three alternatives satisfy the three criteria we apply in this docket, we note that PGE's 17-year recovery alternative is not the preferred outcome. A 17-year recovery period alternative would have imposed a substantial disallowance on PGE at the time of the UE 88 decision, even when combined with the building blocks PGE recommends. Such a substantial disallowance, which would not be based on a finding of imprudence, places a strain on least-cost planning principles. Nevertheless, we conclude that PGE's 17-year alternative provides a reasonable approach and would establish a reasonable UE 88 revenue requirement.

We address below the particular rate making tools and building blocks that are components of the three alternatives identified above.

A. RECOVERY PERIOD

We conclude that a one-year recovery period for PGE's undepreciated investment in Trojan is the preferable alternative, assuming that a retired plant such as Trojan may not be included in rate base. A one-year recovery period is the best alternative to meet the twin requirements of the Court of Appeals' decision, which held that (1) PGE should be

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permitted to recover its undepreciated investment in Trojan; and (2) PGE should not be permitted to earn a return on Trojan. Moreover, a one-year recovery period is more consistent with the first criteria identified above, *i.e.*, encouragement of least-cost planning principles. All else remaining the same, a 17-year recovery period with no return on the Trojan investment would require an initial disallowance of approximately $182 million. Such a disallowance would not be based on an imprudence finding or violation of least-cost planning principles. Indeed, retirement of Trojan would create a substantial net benefit for customers. Under these circumstances, it is difficult to reconcile a 17-year recovery period with least-cost planning principles.

B. NET BENEFITS TEST

In UE 88, the Commission disallowed recovery of $26.8 million (before taxes) on the basis of the net benefits test. The net benefits test compared how customers fared under a Trojan closure scenario with a no-closure scenario. In the net benefits test performed in UE 88, the Commission assumed that in the closure scenario, PGE would be able to recover a return on its undepreciated investment in Trojan. This assumption is no longer justified given the Court of Appeals' decision. Accordingly, we conclude that the Commission would have performed the net benefits test differently in UE 88 had it known that it could not set rates to include a "return on" PGE's undepreciated investment in Trojan. Based on our conclusions elsewhere in this order that $80 million of the Trojan assets should be classified as plant-in-service and that PGE would have been permitted to recover the Trojan investment in one year, the value to customers of such a delay in recovery with no return on Trojan is approximately $17.66 million. Accordingly, on this basis alone, we reverse the $26.8 million disallowance in UE 88 by at least $17.6 million.

We also conclude that we would have exercised our discretion differently with respect to the Commission's decision to exclude the entire cost of replacing Trojan's steam

generators from PGE's cost of continued Trojan operation. In the net benefits test applied in UE 88, the Commission exercised its discretion to not recognize the cost of replacing Trojan's steam generators in the no closure scenario. In Order No. 95-322, the Commission recognized that this decision was an exercise of its discretion and was not based on a finding of imprudence. Indeed, the Commission's standard cost-of-service convention includes such prudently-incurred costs in rates. We conclude that the Commission would not have exercised its discretion in this fashion had it known that rates could not be set to include a return on PGE's undepreciated investment in Trojan. Including the entire prudent cost related to replacement of Trojan's steam generators increases the benefits of closure by $183 million, resulting in a large net benefit to customers. This results in a substantial benefit to customers under either a one-year or 17-year recovery period and justifies reversal of the entire $26.8 million disallowance in UE 88 based on the net benefits test.

C. PLANT-IN-SERVICE

In its initial decision in UE 88, the Commission determined that the accounting classification of Trojan assets would have no effect on rates and, therefore, the Commission classified these assets as abandoned rather than as plant-in-service. The Court of Appeals' decision undermines the basis for the Commission's resolution of this issue. Classification of the Trojan assets to be used for safety, environmental protection and decommissioning as plant-in-service would have an impact on rates given the Court of Appeals' decision that only investments in assets that are "used and useful" may be included in rate base. Accordingly, we reaffirm our decision in UE 88 that assets associated with the Trojan investment provide service necessary for safety, environmental protection and decommissioning. We conclude, based on the record in this remand docket, that $80 million of the Trojan assets would have been classified as plant-in-service had the Commission in UE 88 known of the Court of Appeals' decision.

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D. BALANCE SHEET OPTIONS

At the time of the UE 88 decision, PGE's balance sheet included a customer credit of $111 million from the sale of Boardman, which was being amortized over a 27-year period ending in 2013. We conclude that the Commission would have offset the remaining Boardman credit against an equal amount of undepreciated Trojan investment in UE 88 had it known that ORS 757.355 precluded the Commission from setting rates that included a return on PGE's undepreciated investment in Trojan. This offsetting of the balance sheet entries would have served a number of important regulatory principles. First, it would have lessened PGE's loss from the delayed recovery of its prudent investment in Trojan and therefore would have furthered important least-cost planning principles. Second, with a relatively short recovery period for the Trojan investment (such as one year), the offset would have reduced the rate impact and kept rates stable. Finally, when combined with a one-year recovery period for the Trojan investment, the offset would have served the goal of intergenerational equity among customers because the Boardman sale and the Trojan closure affected customers over the same period of time. The recovery period for Trojan ended in 2011; the recovery period for Boardman ended in 2013.

The Commission has broad discretion to prescribe accounting rules for recovery and depreciation. We conclude that the Commission would have exercised this authority by offsetting the entire Boardman gain credit against the Trojan balance in UE 88.

We also conclude that the Commission could have exercised its discretion to defer a certain portion of the UE 88 test year power costs, as PGE recommends. This deferral is appropriate under ORS 757.259(2)(e) in order to assist in stabilizing rates. Because a one-year recovery period for Trojan could cause a short term rise in rates, it would have been reasonable for the Commission in UE 88 to exercise its discretion to defer these power costs in order to smooth rates. In this remand docket, we do not decide whether or not

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the Commission in UE 88 would have in fact adopted a power cost deferral. We simply conclude that establishing a power cost deferral in UE 88 would have been a reasonable alternative. In this regard, we note that the power cost deferral is used in only one of the three alternatives (PGE's one-year recovery period alternative) that establish the range of reasonable UE 88 revenue requirements.

E. RETURN ON EQUITY AND CAPITAL STRUCTURE

PGE's authorized return on equity was established in UE 88 based on the assumption that the Commission would allow PGE to recover its undepreciated investment in Trojan over time with a return. Now that the Court of Appeals has reversed this fundamental assumption, it is appropriate to reconsider what authorized ROE the Commission would have established for PGE in UE 88. We conclude, based on the record evidence, that the Court of Appeals' decision might have increased the required rate of return that investors demand for investing in PGE and Oregon utilities. Investors would likely view PGE as an above-average risk relative to other utilities, increasing the required rate of return on equity. We conclude that the Commission would have increased PGE's required ROE by between 25 and 150 basis points, depending upon the degree to which PGE's recovery of its investment in Trojan is delayed. Over a one-year scenario, the Commission would have increased PGE's required ROE by 25 basis points. Under a 17-year recovery period, we conclude based on the record evidence that the Commission would have increased PGE's required ROE by 150 basis points.

IV. URP'S AND CLASS ACTION PLAINTIFFS' ARGUMENTS

The vast majority of the opposition argument and testimony filed on behalf of URP and the Class Action Plaintiffs blatantly disregards the Commission's prior conclusion regarding the scope of this docket. URP continues to argue that the Commission should limit itself to a ministerial function. According to URP, the Commission should simply calculate

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the return on Trojan charged to customers while ignoring the impact the Court of Appeals' decision would have had on other elements the Commission analyzed in its efforts to set fair and reasonable rates in UE 88. We incorporate by reference our scoping order, which responded to and resolved URP's arguments on this front.

Suffice it to say, we conclude that (a) we must engage in ratemaking in this docket under our general powers (ORS 756.040) and our specific rate making powers (ORS 757.210 and ORS 757.020); (b) our obligation is to establish what would have been "just and reasonable rates" in UE 88; and (c) we are not confined to a single rate-making component or issue. We have broad discretion in deciding the scope of this proceeding, the additional evidence received into the record, and what findings to make in this remand proceeding. Our discretion is enhanced under these unprecedented circumstances. We have never engaged in a remand proceeding in which the purpose was to consider refunds.

A. DEFERRED TAXES AND CAPITAL STRUCTURE

Mr. Lazar testifies that customers are entitled to the accumulated deferred taxes associated with Trojan and an adjustment to PGE's capital structure. We conclude that both adjustments are unwarranted. They rely on the mistaken assumption that the Court of Appeals' decision required a complete write-off of the undepreciated investment in Trojan. This assumption is wrong. The Court of Appeals' decision concluded that PGE was entitled to recover its undepreciated investment in Trojan.

B. POST-1995 EVENTS

In determining what rates the Commission would have established in UE 88 had it known of the Court of Appeals' decision, URP urges the Commission to consider several events that occurred after 1995. Consideration of these post-1995 events is improper because the Commission's task in this proceeding is to determine what rates would have been approved in UE 88 had the Commission known of the Court of Appeals' decision. The

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Commission could not possibly have known in 1995 about events that occurred later. Accordingly, we conclude that URP's testimony and arguments relating to post-1995 events are irrelevant. Nevertheless, even if we had considered these events, we conclude that they provide no basis for setting just and reasonable rates.

1. Earnings

Even it were proper for the Commission to consider post-1995 events, URP's testimony regarding earnings after 1995 provides no legitimate basis for determining UE 88 rates. It is an inherent element in utility rate regulation that actual conditions effecting costs and revenues will vary from test year conditions. Nonetheless, neither the utility nor its customers can recover for these fluctuations unless affirmative steps are taken under ORS 757.259. While PGE's earnings may have been somewhat higher than expected in the years following UE 88, PGE's earnings in other years have been lower than expected. These fluctuations provide no basis for the Commission's decision in establishing what just and reasonable rates it would have set in UE 88.

2. Enron Acquisition

The price paid by Enron to acquire PGE stock in 1997 does not bear on any issue relevant to a rate-making proceeding. Gains and losses on stock sales are not recognized for rate-making purposes, nor are changes in the market value of assets.

3. Income Taxes

URP suggests that the Commission, in setting UE 88 rates, should consider actual tax payments by Enron and PGE after 1995. We conclude that this does not provide a relevant factor in setting UE 88 rates. Until the Oregon legislature's enactment of SB 408 in the 2005 legislative session, the Commission consistently applied a stand-alone approach for calculating income taxes. There is no basis to conclude that the Commission in UE 88 would have done anything different.

C. RELEVANT PERIOD

The issue in this phase is limited to what the Commission would have approved in UE 88 had it interpreted ORS 757.355 in the way the Court of Appeals did. Accordingly, we need not consider in this docket what rates it would have established in UE 93 or UE 100. Nevertheless, the Commission must consider the rate-making and financial consequences of alternative UE 88 rates through the period from 1995 until the time of the UM 989 settlement. This remand proceeding requires an analysis of the UM 989 settlement based on revised UE 88 revenue requirements. It is, therefore, necessary to show the financial, accounting and rate-making impact over time that would have resulted from different rate decisions in UE 88.

URP submits testimony and comments regarding the specific mechanics of the UM 989 settlement. The Commission will consider in detail the UM 989 settlement later in this docket. Therefore, the Commission need not make any findings in this phase with respect to testimony offered by the parties that solely concern the mechanics of the UM 989 settlement.

URP also offers testimony and comments regarding rates that were in effect in 1992-1995, before UE 88. We find that this testimony is outside the scope of this docket. There is no basis for the Commission to reconsider rates in this proceeding prior to UE 88.

V. CONCLUSION

The Commission finds that had it known that ORS 757.355 did not permit it to set rates to include a return on PGE's undepreciated investment in Trojan, it would have set UE 88 rates to:

1. Recover the entire undepreciated investment in Trojan based on the positive net benefit resulting from comparing the cost of closure to the cost of continued operation and including the effects of the Court of Appeals' interpretation in the cost of closure and steam generator replacement in the cost of continued operation;

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2. Leave $80 million of the Trojan assets in the plant-in-service accounts;

3. Offset the $111 million Boardman gain against the undepreciated Trojan assets that were not still plant-in-service and amortize the remainder over one year;

4. Authorize return on equity of 11.85 percent;

5. Defer a portion of its 1995 and 1996 net variable power costs, for recovery over the subsequent 10 years; and

6. Recover the AMAX termination payment, pre-UE 88 deferred power costs and SAVE incentive over the same 10 years.

This is the Commission's preferred alternative. In addition, the Commission finds that there were other reasonable alternative UE 88 revenue requirements. These include one of the combination of building blocks put forward by Staff (modified as PGE suggests):

1. Recover the entire undepreciated investment in Trojan based on the positive net benefit resulting from comparing the cost of closure to the cost of continued operation and including the effects of the Court of Appeals' interpretation in the cost of closure and steam generator replacement in the cost of continued operation;

2. Leave $80 million of the Trojan assets in the plant-in-service accounts;

3. Offset the $111 million Boardman gain against the undepreciated Trojan assets that were not still plant-in-service and amortized the remainder over one year;

4. Recover the AMAX termination payment, pre-UE 88 deferred power costs and SAVE incentive over the same 10 years; and

5. Authorize return on equity of 11.85 percent.

The Commission also finds the 17-year recovery alternative put forward by PGE would have provided the basis for just and reasonable rates. This option includes the following building blocks:

1. Recover the entire undepreciated investment in Trojan based on the positive net benefit resulting from comparing the cost of closure to the cost of continued operation and including the effects of the Court of Appeals' interpretation in the cost of closure and steam generator replacement in the cost of continued operation;

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2. Receive 20 percent of the positive net benefit created through its economic retirement of Trojan, spread evenly over 17 years;

3. Leave $80 million of the Trojan assets in the plant-in-service accounts;

4. Offset the $111 million Boardman gain against the undepreciated Trojan assets that were not still plant-in-service;

5. Be allowed a required return on equity of 13.1 percent; and

6. Recover the AMAX termination payment, pre-UE 88 deferred power costs and SAVE incentive over three years beginning with UE 88 rates.

We conclude that UE 88 rates set using the three alternatives described above would have been just and reasonable. The Commission finds that, under each of the these three reasonable alternatives, the UE 88 revenue requirement would have been higher than the actual UE 88 revenue requirement set in 1995. PGE's one-year recovery alternative results in a UE 88 revenue requirement that is $6.5 million higher; the second one-year recovery alternative (the modified version of Staff's alternative) is at least $75 million higher; and PGE's 17-year recovery period alternative is $63,000 higher. Accordingly, we conclude that the rates set in UE 88 were just and reasonable because they were lower than the rates the Commission otherwise would have established.

We make the following findings to facilitate our review in future phases of the UM 989 settlement. Under the PGE one-year recovery approach, as of September 30, 2000, customers would have owed PGE approximately $198 million instead of the $180 million Trojan balance that was used to offset against customer credits in the UM 989 settlement. Under the second alternative described above, as of September 30, 2000, customers would have owed an amount greater than $158.9 million. The exact amount owed under this alternative must be established in subsequent phases of this docket given that none of parties conducted a quantitative analysis showing the appropriate balance assuming this precise combination of building blocks. Under PGE's 17-year recovery alternative, as of

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September 30, 2000, customers would have owed PGE about $275 million at the time of the UM 989 settlement.

IT IS SO ORDERED

Made, entered, and effective ______________________________________.

Lee Beyer Chairman	**John Savage** Commissioner
	Ray Baum Commissioner

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CERTIFICATE OF SERVICE

I hereby certify that on this day I served the foregoing **PORTLAND GENERAL ELECTRIC COMPANY'S OPENING POST HEARING BRIEF (PHASE I)** by mailing a copy thereof in a sealed, first-class postage prepaid envelope, addressed to each party listed below and depositing in the U.S. mail at Portland, Oregon.

David Hatton
Department of Justice
Regulated Utility & Business Section
1162 Court Street, N.E.
Salem, OR 97301-4096
stephanie.andrus@state.or.us

Paul A. Graham
Department of Justice
Regulated Utility & Business Section
1162 Court Street, N.E.
Salem, OR 97301-4096
paul.graham@state.or.us

Daniel W. Meek
Daniel W. Meek, Attorney At Law
10949 S.W. Fourth Avenue
Portland, OR 97219
dan@meek.net

Linda K. Williams
Kafoury & McDougal
10266 S.W. Lancaster Road
Portland, OR 97219-6305
linda@lindawilliams.net

DATED this 9th day of November, 2005.

TONKON TORP LLP

By
JEANNE M. CHAMBERLAIN, OSB No. 85169
DAVID F. WHITE, OSB No. 01138
Attorneys for Portland General Electric Company

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