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Douglas C. Tingey
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October 12, 2016

Via Federal Express and electronic filing

Oregon Public Utility Commission
Attention: Filing Center
PO Box 1088
Salem OR 97308-1088

Re: UE 308 – PGE Annual Power Cost Update Tariff (Schedule 125)

Attention Filing Center:

Please find enclosed the redacted version of the Reply Brief of Portland General Electric Company in the above-referenced docket.

The confidential portions of PGE's brief are being handled pursuant to the protective order issued in this proceeding and will follow to the Commission via Federal Express.

Thank you for your assistance. If you have any questions, please do not hesitate to call.

Sincerely,

A handwritten signature in blue ink, appearing to read "DCTing", is written over the typed name.

Douglas C. Tingey
Associate General Counsel

DCT:lgh
Encl.

**BEFORE THE PUBLIC UTILITY COMMISSION
OF OREGON**

UE 308

In the Matter of

PORTLAND GENERAL ELECTRIC
COMPANY

2017 Annual Power Cost Update Tariff
(Schedule 125).

**REPLY BRIEF OF
PORTLAND GENERAL ELECTRIC COMPANY**

Portland General Electric Company (“PGE”) submits this reply brief regarding PGE’s proposed cost-of-service gas hedging transaction.

CONTEXT

There is only one issue remaining. This docket has included multiple rounds of testimony by all parties, workshops, and a hearing with the Commissioners. The parties filed opening briefs last week. The issue has been thoroughly discussed, and all parties’ positions explained at length. PGE explained and supported the proposed transaction, pointing out the benefits to customers in reducing volatility in gas prices by acquiring seven percent of its natural gas needs through this cost-of-service arrangement. PGE has also, in its testimony and previous brief, rebutted the arguments of the other parties.

THIS TRANSACTION SHOULD BE APPROVED

PGE conducted extensive analysis and market assessments of potential long-term hedging opportunities for the benefit of its customers. PGE also spent considerable time and effort in keeping the parties to this docket informed – starting well before this docket was filed. PGE has negotiated a unique and compelling transaction that reduces risk and will enhance long-term customer price stability. The terms of the transaction address feedback and concerns of the parties expressed during the process. [REDACTED]

[REDACTED] The hedge is also projected to be cost effective over the life of the agreement.²

Under PGE’s Mid-Term Strategy gas and electric costs are hedged up to five years in the future. Customers are exposed to gas price risk beyond that five year period, including structural shifts in the market. The proposed cost-of-service transaction will mitigate price swings thereby

¹ Power cost update filed September 30, 2016.

² PGE/600, 5; PGE/700, 2.

decreasing volatility in customer prices. Customers will benefit from the transaction and it should be approved.

RESPONSE TO BRIEFS

PGE will endeavor to not repeat the arguments made in its previous brief, and only address certain issues raised in the briefs of the other parties. Some of those arguments are based on incorrect factual assertions.

Counterparty risk: As discussed in testimony, other parties have exaggerated the counterparty risk of this transaction. In Staff's case, they base part of their argument on incorrect factual assertions contained in Staff testimony, and repeated in their opening brief.

Staff's testimony claimed that PGE's counterparty, [REDACTED]

[REDACTED] Staff further stated: [REDACTED]

[REDACTED] PGE corrected these assertions in its rebuttal testimony, PGE 800. In fact, as shown in PGE's testimony⁵ [REDACTED]

[REDACTED] Staff's claims, repeated in Staff's brief, are factually incorrect.

[REDACTED] In addition, PGE has taken all reasonable steps to mitigate the potential impacts if its counterparty suffers adverse financial conditions.⁸

³ Staff/500, 9.

⁴ *Id.*

⁵ PGE/800, 36.

⁶ *Id.*

⁷ *Id.*

⁸ PGE/800, 25-27.

Guidelines: PGE has stated that it does not require approval or other Commission action on the guidelines in this docket.⁹ The guidelines were proposed to give a framework for future possible long-term hedging transactions. If there are any future long-term hedging transactions, PGE will present them to the Commission for approval. Notwithstanding this, the other parties to this docket have addressed at length the guidelines originally proposed by PGE in this docket. They have also, in some cases, misrepresented the guidelines. PGE addresses these briefly below.

Staff: Staff misrepresents PGE's guidelines. The first proposed guideline states: "Establish that the 'Long-term Projected Cost' must be at or below the comparable 'Long-Term Benchmark Price'."¹⁰ Staff's Opening Brief states that this guideline "applies to ratemaking and does not restrict or guide hedging."¹¹ In fact, the first guideline has nothing to do with rate making and has everything to do with restricting and guiding the cost of long-term hedging. Further, PGE has consistently applied this guideline to all the long-term hedges (including financial swaps) that it has had the opportunity to evaluate, and stated so in its discovery and testimony.¹²

Staff also construes the first guideline as applying "specifically to the ownership of gas reserves rather than long-term hedging in general."¹³ This is incorrect. PGE's opening testimony clarified that "Guidelines 1 and 2 relate to any of the long-term gas hedging alternatives ... Guidelines 3 and 4 relate only to the non-operating working interest form of long-term gas hedging."¹⁴

⁹ PGE/800, 51.

¹⁰ PGE/200, 3.

¹¹ Staff Opening Brief at 13.

¹² PGE/800, 42-43.

¹³ Staff Opening Brief at 13.

¹⁴ PGE/200, 3.

Staff also argues that “The second guideline that prescribes a fixed percentage of PGE's gas needs subject to long-term hedges is not necessarily desirable in that it is not responsive to market conditions.”¹⁵ Staff continues: “PGE's proposed guidelines are not responsive to market conditions, but are tailored specifically to facilitate the acquisition of gas reserves...”¹⁶ As noted above, the first guideline specifies a comparison to the benchmark price, which reflects the current long-term market forecast. In addition, the guidelines would all have to apply, not just one.

CUB: CUB's testimony and opening brief state that:

“PGE is proposing a set of Guidelines that would require the Company to purchase at least 15%, and up to 30%, of its natural gas supply under long term contracts.”¹⁷ That is incorrect. The purpose of the second guideline is to set an appropriate limit to long-term hedging and PGE based its proposed range on a detailed study provided in discovery and then as PGE Exhibit 801. No party challenged this study as inaccurate or inapplicable. Finally, the range was never intended to represent a requirement, as explained in PGE's rebuttal testimony:

[W]e proposed a ceiling range within which PGE's long-term hedging would be limited and would evaluate potential transactions within those limits (i.e., the Commission could set the ceiling anywhere from 15% to 30% of PGE's average gas requirement). Further, PGE would only propose transactions if they meet all other guidelines and a normal prudence review. Only a Commission order instructing PGE to achieve certain levels of hedging would create a requirement, and that is not what PGE is proposing.¹⁸

CUB also misstates the expected life of PGE's gas plants. CUB's testimony and opening brief state that:

¹⁵ Staff Opening Brief at 13.

¹⁶ Staff Opening Brief at 13-14.

¹⁷ CUB Opening Brief at 2; *citing* CUB/200/Jenks/2

¹⁸ PGE/800, 6.

██████████—extending beyond the life of the current IRP and beyond the life of PGE’s generating assets.”¹⁹ PGE’s rebuttal testimony noted that “PGE’s gas-fired thermal plants have 45-year useful lives and their depreciation schedules are currently set at this level based on PGE’s most recent depreciation study (Docket No. UM 1679) as approved by Commission Order No. 14-297.”²⁰ The life of the plants is expected to significantly exceed the length of this hedging transaction.

ICNU “risk premium” discussion: ICNU claims PGE did not dispute the accuracy of their analysis. PGE did. As shown in ICNU Exhibit 300 (pages 3 and 4 of 5), PGE explained that the analysis done by ICNU does not show a “risk premium”. Instead, ICNU’s analysis only reflects:

- How accurately the futures market has predicted future price activity, which is inherently difficult and imprecise; and
- how effectively hedges based on those futures “beat the market.”

PGE also explained that the fundamental value of hedging is in the reduction of price volatility and the true measure of the risk premium observed through hedging is the difference between prices in fixed price transactions at a given point in time. For example, locking prices for ten years will be more expensive than locking prices for five years, which will be more expensive than locking prices for one year. This price difference implicitly represents the premium paid for the extended price certainty.

Customer desire for less volatility: It is surprising to see Staff, CUB and ICNU argue that customers do not want lower volatility. PGE has provided evidence they do.²¹ Other parties have criticized that evidence, but have not produced evidence to the contrary. There is no

¹⁹ CUB Opening Brief at 15, *citing* CUB/200/Jenks/5.

²⁰ PGE/800, 43.

²¹ PGE/800, 16; PGE/802.

evidence in the record to suggest customers' desires have changed to render the surveys dated or invalid.

The arguments of Staff, CUB and ICNU are against hedging in general. Hedging has long been part of utility practices. In Docket UE 228, the Commission addressed PGE's Mid-Term Strategy hedging program that hedges some of PGE's gas and electric position out 5 years. In the Order in that docket the Commission stated:

We conclude that PGE's overall hedging strategy to be prudently designed. Specifically, we find that the MTS is a reasonable approach to addressing the three-year period between the company's short-term hedges and purchases and the company's long-term resource investment, and agree that the appropriate goal is to address PGE's entire NOP.²²

The parties' arguments appear inconsistent with the Commission's determination regarding PGE's hedging. The cost-of-service hedge at issue here provides the same protection against volatility, but for a longer time frame. The question is not whether hedging in general is appropriate – the Commission has determined that it is. The question is whether this hedge, with its unique terms and benefits to customers, should be approved. The parties' arguments against all hedging are misplaced.

Revenues for oil and non-gas liquids (NGLs): Though only addressed briefly in testimony, the briefs of Staff and ICNU discuss the impact of oil and NGL revenues on the efficacy of this hedge. There will be oil and NGL revenue that will be credited to fuel costs. PGE has stated that it will hedge the price of the oil and NGL production to the extent it is able to.²³ Currently, hedges up to ten years exist for oil prices, and for NGLs up to three years.²⁴

PGE notes as well, [REDACTED]

[REDACTED]

[REDACTED]

²² Order 11-432, p. 8.

²³ PGE/800, 30.

²⁴ ICNU/301, 1 of 2.

NRRI opinion piece. The briefs of Staff (at 12) and ICNU (at 11-12) both reference the National Regulatory Research Institute (NRRI) study as support for their opposition to PGE's proposal. The NRRI study, however, is not as definitive or applicable as the Parties claim.

ICNU argues that the NRRI study "evaluated a number of vertical arrangements for gas procurement by utilities, including proposals like PGE's ...".²⁵ PGE's proposed transaction contains several unique aspects. Given that, the NRRI study could not have evaluated it and did not address the unique aspects.

While the NRRI study notes the benefits of a diversified portfolio plus other benefits of long-term gas hedging (see Table 1 of ICNU/202), these are not accorded the same level of consideration as the potential negative effects. All aspects of a proposed transaction should be considered. In addition, several of the concerns raised by the NRRI study (Section VII of ICNU/202) are either hypothetical (e.g., disputable role of vertical arrangements in a robust gas market), do not apply (e.g., overestimate of gas-cost savings, potential for self-dealing abuses), or are speculative (e.g., a false motive).

The NRRI study also contradicts itself by emphasizing the significance of the negative impacts while at the same time noting how small the vertical arrangements are relative to the utility's total gas needs such that they would have a minimal effect on the average cost of gas.²⁶

Ultimately, the NRRI study presents general recommendations to Commissioners. The Oregon Commission, however, has emphasized its independence in past proceedings with regard to other Commission decisions:

- "PGE's argument that a PCA with a deadband is a significant departure from how other states regulate utilities is not, to staff's knowledge, the type of argument this Commission has ever found to be persuasive."²⁷

²⁵ ICNU Opening Brief at 11.

²⁶ ICNU/202, 52.

- Commission Order No. 07-015 (at 20) summarizes the previous bullet as: “Staff asserts the Commission typically does not rely on the practice of other state commissions. See Staff opening brief, 18.”
- Commission Order No. 01-777 (at 34) “Capital market conditions, not regulatory decisions, determine a utility’s cost of capital.”
- Commission Order No. 01-777 (at 34) “... a review of past decisions [by other regulatory agencies] cannot replace an independent analysis of current market conditions and how they affect the particular utility.”

This transaction needs to be analyzed on its own merits. PGE has negotiated a unique arrangement with several provisions to mitigate risks, and increase the value of the transaction in dampening future volatility of gas prices. For the reasons explained at length in PGE’s testimony, this transaction is in customers’ interests and should be approved.

This AUT is a proper docket to address this transaction. PGE’s testimony, and opening brief, addressed why it is proper to include this hedge transaction in this AUT docket. Other parties have repeated their arguments, and we will not repeat our responses here. PGE does note, however, that whether the other parties’ arguments are characterized as procedural or substantive, if they are adopted the effect is that this time-limited opportunity will be lost.

Other parties characterize this cost-of-service hedging transaction as a rate base investment, and then assert that it should be included in the IRP process and then a general rate case.²⁸ There is an investment aspect to this – that is how cost-of-service gas is acquired. But this is to fuel existing plants, not future plants. The impact of this on customers is to reduce volatility – as a hedge is intended. Again, if this is delayed to an IRP process, this transaction will be lost.

²⁷ UE 180, Staff Opening Brief at 18.

²⁸ CUB/200, 17; Staff Opening Brief at 14; ICNU/Opening Brief at 7.

Parties also attempted to argue that approval of this transaction will be tantamount to approval for all future cost-of-service arrangements.²⁹ That is incorrect. This contract itself allows for additional drilling, but that would be done only after seeking and obtaining Commission approval. Any other deals would also be presented to the Commission for approval, and would stand on their own merits. The Commission retains its regulatory abilities, and the parties' concerns are overstated.

Florida Decision: CUB's final legal argument is that "PGE's proposal potentially falls outside the statutorily defined activities of a 'public utility' which the Commission is authorized to oversee."³⁰ As a threshold matter, CUB's argument should be discounted because it rests on a Florida court decision that is based solely on Florida statutes that have no application here.

As to the merits, CUB's argument is as unclear as it is unpersuasive. CUB's argument would appear to hinge on the definition of 'public utility' but PGE is a public utility under Oregon law, the proposed transaction would not change that fact, and CUB never suggests otherwise. Nor does any Oregon law prohibit public utilities from engaging in this type of transaction and again CUB points to no Oregon law to the contrary.

CUB's argument must then be that the Commission lacks authority to approve the cost of the transaction in rates. While this position is at least clear, it is also clearly wrong. The Commission has broad authority when setting rates subject only to statutory and constitutional limits.³¹ The Commission has a broad mandate to set rates that are fair, just, and reasonable under its general powers statute (ORS 756.040) and specific ratemaking provisions (ORS 757.210). The Legislature further instructed that these laws should be "liberally construed" in a

²⁹ CUB/200, 34; ICNU Opening Brief at 8.

³⁰ CUB Opening Brief at 20.

³¹ Gearhart v Public Utility Commission of Oregon, 255 Or.App. 58, 61 (2013).

manner consistent with this general directive. Accordingly, Oregon courts have consistently recognized the broad legislative grant of authority to the Commission.³²

CUB offers no real evidence that the requested approval exceeds the Commission's authority. The proposed transaction would result in a fuel cost through the purchase of natural gas from an affiliate. This is no different in nature than any other fuel cost PGE proposes to include in rates. The fact that PGE includes the cost through an affiliate agreement is authorized by Oregon law (ORS 757.495). The requested rule waiver is also expressly authorized by rule (OAR 860-027-0000).

In short, Oregon law confers broad authority on the Commission in this area, the request fits squarely within the Commission's powers, no statute prohibits PGE from engaging in this type of transaction or including the costs in rates; and, in fact, the specific statutes that apply (ORS 757.210 and ORS 757.495) expressly authorize PGE to include this type of cost in rates.

CONCLUSION

PGE requests approval of this contract and its inclusion in 2017 AUT power costs.

DATED this 12th day of October, 2016.

Respectfully submitted,



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³² Gearhart v Public Utility Commission of Oregon, 356 Or. 216, 220 (2014) (“Ratemaking is a unique enterprise that is governed by statute but largely left to the PUC’s discretion”); American Can v Lobdell, 55 Or.App. 451, 462-63(1982).