

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).)
_____)

**OPENING BRIEF
OF THE
CITIZENS' UTILITY BOARD OF OREGON**

October 3, 2016



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I. Introduction

A. Procedural Posture

Pursuant to Administrative Law Judges (“ALJ”) Arlow and Harper’s September 22, 2016 Ruling, the Citizens’ Utility Board of Oregon (“CUB”) submits its Opening Brief in docket UE 308.

On April 1, 2016 Portland General Electric (“PGE” or “the Company”) filed its 2017 Annual Update Tariff (“AUT”).¹ The filing introduced both its AUT forecast of 2017 Net Variable Power Costs (“NVPC”) and the Company’s proposal to implement what it refers to as a “long-term gas hedging program.”² CUB refers to the Company’s proposal in a more fitting manner—as a proposal to ratebase natural gas reserves.³ The

¹ See generally UE 308 – PGE/100/Tinker-Sims.

² UE 308 – PGE/100/Tinker-Sims/1, lines 7-9.

³ See UE 308 – CUB/100/Jenks-Hanhan/3-4.

Company is specifically proposing to do so as an alternative to entering into a long-term financial hedge.⁴

On April 18, 2016, parties to this docket participated in a pre-hearing conference call to determine the procedural schedule.⁵ CUB expressed concerns about the timeline for reviewing PGE’s long-term hedging proposal.⁶ Parties eventually agreed on a bifurcated schedule to allow sufficient opportunity to conduct specific discovery on PGE’s proposal to ratebase natural gas reserves.⁷ Parties reached an agreement in principle resolving all issues except those related to the proposal to rate base natural gas reserves.⁸ As such, this Opening Brief will only touch on live issues related to the Company’s gas reserves investment.

B. The Company’s Proposal

PGE is proposing a significant and highly speculative change in how it secures fuel for its power plants.⁹ First, 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.¹⁰ Second, PGE is proposing a contract with [REDACTED] (the “drilling partner”) that requires the Company to make a ratebased capital investment of [REDACTED] [REDACTED]¹¹ in a drilling program that includes [REDACTED] [REDACTED]¹² and [REDACTED] [REDACTED]¹³ In addition to the capital investment, PGE would pay a share of the

⁴ UE 308 – CUB/100/Jenks – Hanhan 4, lines 4-6.

⁵ UE 308 – CUB/100/Jenks – Hanhan/3, lines 4-5.

⁶ *Id.* at lines 5-6.

⁷ *Id.* at lines 10-13.

⁸ *In re Portland General Electric Company 2017 Annual Power Cost Update*, Docket No. UE 308, Ruling (July 8, 2016).

⁹ UE 308 – CUB/200/Jenks/2, lines 6-7.

¹⁰ UE 308 – CUB/200/Jenks/3, lines 26-27.

¹¹ UE 308 – PGE/600/Russell – Tooman/3.

¹² *Id.*

¹³ *Id.*

operating costs.¹⁴ The contract allows for PGE and its drilling partner to continue to invest in subsequent wells over each year from 2018 – 2021.¹⁵ Finally, PGE’s proposal requests that a prudence review of this investment in the time sensitive AUT with the produced natural gas sold to customers under traditional cost-of-service ratemaking.¹⁶

PGE mischaracterizes its proposal as a gas hedge, which it sees as the acquisition of a physical or financial position that reduces or offsets the risk of market price volatility for fuel to operate its gas-fired thermal plants.¹⁷ The Company asserts that gas hedging is important because customers have indicated that they prefer price stability.¹⁸ However, this assertion is misleading. Upon review of PGE’s own, and cited-to, customer feedback survey from its 2007 Integrated Resource Plan (“IRP”), residential customer participants indicated that they were unwilling to accept price increases for long-term price stability.¹⁹ In advocating on behalf of Oregon’s residential utility customers, CUB notes that its constituents are not willing to pay more for utility service in the name of price stability as the Company has indicated.²⁰

C. Controlling Law

In order to recover a capital investment of this magnitude, PGE must demonstrate that the investment is presently used and necessary for providing utility service, and that the investment was prudently made based on the information that the utility knew or

¹⁴ UE 308 – CUB/200/Jenks/4, lines 3-4.

¹⁵ *Id.* at lines 4-6.

¹⁶ *Id.* at lines 7-9.

¹⁷ UE 308 – PGE/100/Tinker – Sims/4, lines 2-3.

¹⁸ *Id.* at line 5, citing *In re Portland General Electric*, Docket No. LC 43, 2007 Integrated Resource Plan, p. 135-144 and Appendix F (June 29, 2007).

¹⁹ *In re Portland General Electric*, Docket No. LC 43, 2007 IRP at 138-139.

²⁰ *Id.*

should have known at the time.²¹ That standard applies in this case. The utility bears the burden of proof for both of these requirements regarding the recovery of capital investments.²² Since natural gas is readily available on a well-functioning, liquid, competitive market, it is not necessary for PGE to make a capital investment in its only drilling program.²³ A threshold question in this matter is whether it is a generally prudent strategy to exchange the risks of a *purchaser* on the competitive natural gas market for the different risks of a natural gas *developer*.²⁴

D. Argument Summary

As stated throughout testimony in this docket, CUB strongly urges the Commission to reject the Company's proposal.²⁵ Based on review of testimony filed by Commission Staff, the Industrial Customers of Northwest Utilities ("ICNU"), and PGE, not one non-Company party to this case believes that PGE's proposal should be approved. CUB takes issue with PGE's proposal for a litany of reasons discussed herein that we hope will provide the Commission guidance in its decision-making process.

First, approval is not warranted because PGE's proposed ratebased investment in gas reserves is not appropriate for a prudence review in the limited timeframe of the AUT.²⁶ Nor is approval appropriate because a ratebased investment in gas reserves is not a variable power cost eligible for recovery in Schedule 125.²⁷ The AUT process is

²¹ ORS § 757.355(1); *see, e.g., In re Portland General Electric Company*, Docket No. UE 102, Order No. 99-033 at 36-37.

²² ORS § 757.210(1)(a).

²³ UE 308 – CUB/200/Jenks/5, lines 19-21.

²⁴ *Id.* at 9, lines 7-9.

²⁵ *See generally* UE 308 – CUB/100/Jenks – Hanhan; *and* UE 308 – CUB/200/Jenks.

²⁶ *See* UE 308 – CUB/100/Jenks – Hanhan/4-13.

²⁷ *Id.*

simply not the correct process.²⁸ Second, even if the Commission finds the AUT to be the appropriate process, policy considerations dictate that the exploration, drilling, and development of out-of-state natural gas wells are not legitimate activities for an Oregon-regulated electric utility.²⁹ Third, the terms of the Company's contract with the drilling partner do not adequately reduce risk, and the contract itself is imprudent.³⁰ Fourth, PGE's proposed long-term hedging guidelines are not reasonable, and should be rejected.³¹ Finally, approval of the Company's proposal may exceed the Commission's statutory authority. This Opening Brief explores each individual issue in turn.

II. Argument

A. Ratebased Investments in Natural Gas Reserves Do Not Belong in the AUT

The Company's proposed ratebased investment in gas reserves is not a variable power cost eligible for recovery in Schedule 125.³² The Company is proposing to become a gas producer through gas production property acquisition rather than its traditional role of a natural gas purchaser engaged in market transactions.³³ The Company's proposal is unlike the fuel costs that are normally considered in the AUT, and it is much more similar to a ratebased investment that

²⁸ *Id.*

²⁹ *See* UE 308 – CUB/200/Jenks/4-11.

³⁰ *See* UE 308 – CUB/200/Jenks/19-32.

³¹ UE 308 – CUB/100/Jenks – Hanhan/21, line 7.

³² *Id.* at 4.

³³ *Id.* at 4, lines 6-8, citing UE 308 – PGE/100/Tinker – Sims/7.

is typically reviewed in a general rate case with an extended schedule.³⁴ The Company's proposal does not belong in the AUT.

i. The Historic Purpose of Schedule 125 is Limited to Variable Power Costs

Including the Company's proposal in the AUT runs counter to the historic purpose of Schedule 125 that established the mechanism.³⁵ The purpose of this docket is to identify the NVPCs that can be recovered under PGE's Schedule 125, which was established in 2002.³⁶ In the initial AUT case, PGE filed a modeling enhancement that CUB believed went beyond a simple cost update, and CUB, in turn, proposed various rate base adjustments.³⁷ Staff and PGE opposed CUB's rate base adjustment because the docket was limited to variable power costs.³⁸ Indeed, PGE was clear that Schedule 125 was limited to variable power costs:

PGE contends that the scope of this proceeding is limited under Schedule 125 to the examination of variable power costs. It argues that CUB's proposed adjustments relating to fixed costs are outside the scope of the changes considered in this annual RVM update.³⁹

The Commission resolved those disputes by stating that Schedule 125 was limited to variable power costs, and that updates after April 1st were to be limited:

First, the annual update of PGE's RVM should not be the equivalent of a generation rate case. Rather, it should be a proceeding to review PGE's *net variable power costs*. Second, the company should file proposed model enhancements and data updates for the 2004 RVM adjustment by April 1, 2003, to give interested parties and the Commission sufficient time for review. The only changes allowed after that time should be limited to updates and for load

³⁴ *Id.* at 3, lines 7-10.

³⁵ *See In re Portland General Electric Company's Application for Annual Adjustment to Schedule 125 under the terms of the Resource Valuation Mechanism*, Docket No. UE 139, Order No. 02-772 (Oct. 30, 2002).

³⁶ UE 308 – CUB/100/Jenks – Hanhan/4, lines 10-11.

³⁷ *Id.* at 4, lines 11-13. CUB notes that the AUT represents a renamed mechanism, and that the initial adjustment was called the annual resource valuation mechanism ("RVM"). *See* Order No. 02-772 at 1.

³⁸ UE 308 – CUB/100/Jenks – Hanhan/4, lines 13-15.

³⁹ Order No. 02-772 at 5.

forecasts, new power purchase or sales contracts, new fuel contracts, and forward price curves for electricity and gas.⁴⁰

The purpose of Schedule 125 is to define procedures for annual rate revisions due to changes in the Company's projected Net Variable Power Costs update.⁴¹

PGE's proposal to make a major long-term capital investment in natural gas reserves with a return on that investment does not constitute a variable power cost.⁴² Significant capital investments are typically and appropriately given prudence review in general rate cases where parties are given ample time to complete and analyze such a review.⁴³ Capital investments are not variable costs—they are fixed and have a predictable cost of the return of and return on the ratebased investment.⁴⁴ If the Commission finds this capital investment to be prudent, a predictable set of fixed costs (return of and return on a capital investment) will be used to establish rates.⁴⁵ The act of dividing the fixed cost by terms does not change the fact that the proposed transaction is a forward looking ratebased investment.⁴⁶ Approving the Company's proposal has the potential to set a dangerous precedent. If a capital investment of this nature is allowed in the AUT, then a contract for an affiliate to build and run a power plant for PGE and sell the power to the Company on a cost of service basis should be allowed as a "power purchase contract." The method and idea is the same.

⁴⁰ *Id.* at 6 (emphasis added).

⁴¹ Portland General Electric Company's Schedule 125, P.U.C. Oregon No E-18; *see* UE 308 – CUB/100/Jenks – Hanhan/5, lines 4-6.

⁴² UE 308 – CUB/100/Jenks – Hanhan/5, lines 7-9.

⁴³ *Id.* at lines 9-11.

⁴⁴ *Id.* at 11-12.

⁴⁵ *Id.* at 12-14.

⁴⁶ *See generally* UE 308 – PGE/100/Tinker – Sims.

ii. PGE Does Not Demonstrate that the Proposal is a Variable Cost

PGE's proposal is not a variable power cost.⁴⁷ In this instance, the variable is not cost, but rather the production levels of the proposed wells.⁴⁸ The Company's proposal is not eligible under Schedule 125, and PGE should bring this ratebased investment to the Commission in a general rate case, as it would any other significant ratebased investment.⁴⁹ Throughout this docket, PGE has not adequately demonstrated how its proposal is a variable cost eligible for recovery in Schedule 125.⁵⁰ In a Data Request, CUB asked the Company to explain: 1) how a capital investment in natural gas reserves is a variable power cost and not a fixed cost; 2) what its basis is in including a long-term ratebased investment in the AUT; 3) what the basis is in seeking prudence determination of a long-term ratebased investment in the AUT; and 4) whether the Company has ever proposed recovery of a ratebased asset in its AUT filings.⁵¹ PGE's answers were not sufficiently compelling:

PGE's proposal calls for an affiliated entity, Portland General Gas Supply Co. (PGGS) to transact for gas reserves. As a result, PGGS will have a capital investment. PGGS will then sell the produced gas to PGE on a cost-of-service basis in accordance with the terms of the Purchase Gas Agreement, submitted as part of PGE's request in Docket No. UI 371. Because PGE will use this gas as fuel for its gas-fired thermal plants, it is no different than other gas purchases and/or physical hedges, which are appropriately treated as variable power costs and included in PGE's power cost forecast (i.e., AUT filings) and actual power costs (i.e., PCAM filings). As noted in part d, below, the price that PGE pays for these purchases undoubtedly includes a fixed cost component such as return on and of capital.⁵²

The Company further stated:

⁴⁷ UE 308 – CUB/100/Jenks – Hanhan/5, line 14.

⁴⁸ *Id.* at 5, lines 15-16.

⁴⁹ *Id.* at 5, lines 15-17.

⁵⁰ *Id.* at 5, line 18.

⁵¹ *Id.* at 5-6; *see* CUB Exhibit 102.

⁵² *Id.*

PGE is seeking a prudence determination for the cost per MMBtu of its proposed long-term gas hedge to be included in AUT filings. We believe this to be very similar to the NW Natural determination in Commission Order No. 11-176, wherein the cost of NW Natural's long-term gas investment will be included in its annual purchased gas adjustment mechanism.⁵³

And:

PGE proposes to include cost-of-service gas in its AUT filings as described in PGE Exhibit 300, Section IV. Specifically, the AUT inputs to PGE's MONET model will include the cost per MMBtu and average daily gas volume. These amounts are appropriate to include in PGE's AUT filing because Schedule 125-1 specifies that the following updates "will be made in each of the Annual Power Cost 32 Update filings":

- Contracts for the purchase or sale of power and fuel.
- Changes in hedges, options, and other financial instruments used to serve retail load.⁵⁴

Order No. 11-176, referenced by the Company, was the Encana Order in UM 1520.⁵⁵ That case was not the PGA, but was an unusual single-issue ratemaking docket established for the sole purpose of examining the prudence of NW Natural's ("NWN") ratebased investment in gas reserves.⁵⁶ Unlike the AUT, UM 1520 was not an annual docket designed to consider variable costs.⁵⁷ UM 1520 demonstrates why capital investments are more typically handled in a general rate case.⁵⁸ A problem with determining how to treat capital investments in rates is that there are several parts to any given capital investment, including the investment itself and the financing of it.⁵⁹ The *only* time ratemaking examines financing costs is during a general rate case.⁶⁰ As such, there was an unusual provision in UM 1520 that required NWN to file a general rate case

⁵³ *Id.*

⁵⁴ *Id.*

⁵⁵ UE 308 – CUB/100/Jenks – Hanhan/7, line 1.

⁵⁶ *Id.* at 7, lines 1-3.

⁵⁷ *Id.* at 7, lines 4-5.

⁵⁸ *Id.* at 7, lines 5-6.

⁵⁹ *Id.* at 7, lines 7-9.

⁶⁰ *Id.* at 7, lines 9-10 (emphasis added), citing *in re Application for Deferred Accounting Order Regarding Purchase of Natural Gas Reserves*, Docket No. UM 1520, Order No. 11-176 at 4 (May 25, 2011).

and give a full refund to customers if the actual cost of financing was below was had been forecast in NWN's previous general rate case.⁶¹

The outcome of UM 1520 provides further guidance in this matter, as there was a recognition in that docket that the short timeline only gave opportunity for a limited prudence review, and that a full prudence determination may require further review.⁶² The marked similarities between the two dockets and proposed transactions further demonstrates that review of the Company's proposal in the AUT is inadequate.

As quoted *supra*, CUB Exhibit 102 contains PGE's complete explanation for why it believes this is a variable power cost and why the prudence of a significant capital investment should be included in the AUT, which examines variable power costs.⁶³ CUB does not agree with PGE's characterization that acquisition of gas production properties are "no different than other gas purchases."⁶⁴ Contracts for the purchase or sale of power and fuel and changes in hedges, options, and financial instruments⁶⁵ are purchased directly from the market, and prudence can be demonstrated by comparing these purchases to other market options.⁶⁶ This is a ratebased investment, and prudence must be determined by PGE's examination of the various risks associated with this specific deal—including risks associated with environmental liability, royalties, future regulation,

⁶¹ *Id.* at 7, lines 10-13.

⁶² *Id.* at 7, lines 14-15, citing Order No. 11-176 at Appendix A, p. 6 ("[T]he Parties agree that given the unique nature of the Proposed Transaction, the Commission should make a finding of prudence at this time based upon the information the Parties have reviewed. However, the Parties recognize that the review in this case has been expedited and that, in the future, new information, not made available to Staff and the intervening parties, arises which demonstrates that NW Natural knew, or should have known, something of consequence to the Proposed Transaction at the time of the Proposed Transaction, Staff and the intervening parties can then use that information to challenge the prudence of the Transaction.").

⁶³ UE 308 – CUB/100/Jenks – Hanhan/8, lines 11-13.

⁶⁴ CUB Exhibit 102.

⁶⁵ See PGE's Schedule 125.

⁶⁶ UE 308 – CUB/100/Jenks – Hanhan/8, lines 17-19.

and production levels.⁶⁷ The Company has failed to demonstrate that its proposal represents a variable cost eligible for recovery in Schedule 125.

iii. There is Insufficient Time in the AUT for an Adequate Prudence Review

Aside from representing a non-variable cost and subsequently being inappropriate for the AUT, the AUT is the incorrect process because there is insufficient time for an adequate prudence review.⁶⁸ Ratebased investments are typically reviewed in a general rate case with a nine-month timeline.⁶⁹ With a seven-month timeline, the AUT is a shorter proceeding meant to consist of simpler issues.⁷⁰ However, it is important to note that PGE did not file any analysis of the proposed transaction with its original AUT filing in this docket—it was all added as an AUT update.⁷¹ No documents related to PGE’s actual internal prudence review of the proposed transaction were made available until July 13th—one month before testimony was due.⁷² Many were not provided until July 23rd, effectively giving CUB and other parties three weeks to review the actual investment.⁷³

Bringing in a significant long-term capital investment with a unique set of risks as an update in the AUT process simply does not leave CUB and other parties the necessary time to conduct a proper prudence review.⁷⁴ PGE itself was rushing to finish its review so it could sign the contract.⁷⁵ Attempting to gain pre-approval of this

⁶⁷ *Id.* at 8, lines 20-23.

⁶⁸ *See* UE 308 – CUB/200/Jenks/12.

⁶⁹ *Id.* at 12, lines 7-8.

⁷⁰ *Id.* at 12, lines 8-9.

⁷¹ *Id.* at 12, lines 10-11

⁷² *Id.* at 13, lines 1-3

⁷³ *Id.* at 13, lines 3-4.

⁷⁴ *Id.* at 16, lines 23-25.

⁷⁵ *Id.* at 16-17, lines 25, 1.

ratebased investment through an AUT update is an attempt to put a large square peg through a tiny round hole.⁷⁶

iv. CUB's Recommendation: PGE Should Use IRPs and GRCs to Plan and Demonstrate Prudence of Capital Investments

If PGE wants to make significant long-term capital investments related to power supply, the regulatory treatment should be through the normal ratemaking process.⁷⁷ The Company should utilize Integrated Resource Planning to plan for large capital investments, and should use general rate cases for prudence review and determination.⁷⁸ The IRP would examine the long term gas needs and model the options to meet those needs. If an acknowledged IRP action plan included a long term gas reserves investment to meet the Company's gas needs, then the Company would negotiate a deal and bring it to a general rate case. At this point in time, the issue of whether a long term gas investment was reasonable would have been largely settled by the IRP acknowledgement, so the issue in the rate case would be the prudence of the particular investment.

Typically, in a general rate case proceeding, the Company's shareholders bear the risk of a potential prudence disallowance, but are rewarded on that risk with a return on equity if their investment is recoverable.⁷⁹ In the proposed transaction, the Company is seeking pre-approval, effectively shifting all risk to consumers while its shareholders are able to earn a return on equity. This is unfair, and equity considerations dictate that the AUT process is inherently unfit for a transaction of this nature.

⁷⁶ *Id.* at 17, lines 1-2.

⁷⁷ *Id.* at 17, lines 5-7.

⁷⁸ *Id.* at 17, line 7.

⁷⁹ See *In re Portland General Electric Company*, Docket Nos. DR 10, UE 88, and UM 989, Order No. 08-487 (Sep. 30, 2008).

B. The Company’s Proposal is not a Legitimate Activity for an Oregon Regulated Electric Utility

CUB does not believe that an electric utility like PGE should be entering into a contract of this nature. In a production setting, as opposed to a typical financial hedge, a gas reserves drilling program does not lock in a price or an amount.⁸⁰ In addition to cost risk, there are also risks associated with production levels, environmental liability and remediation, future climate change regulation, technology changes that could change the utility business model, the value of [REDACTED], and the changing plan of the drilling partner.⁸¹ While some of these risks can be reduced by contract, all of them are inherent to long-term natural gas production.⁸²

i. Resource Choice

PGE would be incentivized to build additional gas plants if this proposal is approved.⁸³ PGE notes that “gas generation will account for over 40% of [its] energy portfolio in 2017.”⁸⁴ The appropriate regulatory solution to a growing dependence on natural gas should not be to increase the incentive to invest in gas plants.⁸⁵

⁸⁰ UE 308 – CUB/200/Jenks/9, lines 9-11.

⁸¹ *Id.* at 9, lines 9-22, *see also id.* at 20-31.

⁸² *Id.* at 10, lines 1-3. *See also In re Black Hills Energy*, 2016 Neb. PUC LEXIS 50, *23-33 (Neb. P.S.C. July 19, 2016) (in which the Nebraska PSC denied a utility company’s proposal to acquire gas reserves due to the (1) lack of proof that a stable price would translate to cost savings and other benefits to ratepayers; (2) shift of a significant risk to ratepayers for a long-term speculative program; (3) lack of regulatory oversight of future costs and expenses incurred; and (4) lack of detail as to how the gas will be produced and marketed); *In re Black Hills/Colorado Gas*, 2016 Colo. PUC LEXIS 456, *19-33 (Colo. P.U.C. May 17, 2016) (in which the Colorado PUC denied approval of gas reserve acquisitions for similar reasons to the Nebraska PSC).

⁸³ *See id.* at 10.

⁸⁴ UE 308 – PGE/100/Tinker – Sims/9.

⁸⁵ UE 308 – CUB/200/Jenks/10, lines 9-10.

ii. Build Versus Buy Incentive

The Commission requires competitive bidding before a utility invests in a large, new power plant, such as a gas plant.⁸⁶ Because utilities have an incentive to build their own plants, the competitive bidding process is overseen by an Independent Evaluator.⁸⁷ Allowing a utility to ratebase 30% of its fuel supply will increase the bias towards utility ownership of gas plants.⁸⁸

iii. Different Than Utility Investment in Coal

Although electric utilities have been allowed to make capital investments in long-term coal supply, those investments are significantly different.⁸⁹ Coal is not sold on the same sort of transparent, liquid, competitive market as natural gas.⁹⁰ When utilities were making the choice to invest in coal reserves, they faced a choice to either build a coal plant near a load center and ship the coal by rail, or build the plant near a coal mine and ship the electricity via transmission lines.⁹¹ The equivalent in this circumstance would be if PGE was considering a gas plant located at the gas reserve location as a way to avoid pipeline charges.⁹²

C. The Terms of and Risks Associated with the Proposed Contract are Imprudent

The proposed contract between PGE and its drilling partner does not adequately mitigate risk. The proposed contract contains a significant level of risk for customers that would not exist under traditional gas procurement. PGE's contract includes the current investment considered here, and anticipates additional investments over the next five

⁸⁶ *Id.* at 10, lines 18-19.

⁸⁷ *Id.* at 10-11, lines 19-20, 1.

⁸⁸ *Id.* at 11, lines 7-8.

⁸⁹ *Id.* at 11, lines 10-11.

⁹⁰ *Id.* at 11, lines 12-13; *see also Id.* at 6.

⁹¹ *Id.* at 11, lines 14-16.

⁹² *Id.* at 11, lines 17-19.

years.⁹³ The contract anticipates a thirty-five year⁹⁴ supply—extending beyond the life of the current IRP and beyond the life of PGE’s generating assets.⁹⁵ The length and uncertain nature of the contract exposes consumers to a variety of risks.

i. Regulatory and Environmental Risk

According to the Company:

Risks related to water include the potential counterparty’s operational procedures and resulting likelihood to contaminate groundwater and surface water, the natural quality of water that could potentially be contaminated in the event of an incident, and the likelihood of water in the vicinity of the project site to have a beneficial use.⁹⁶

PGE also identifies non-attainment and non-compliance as an ozone-related risk, including the “impacts to PGE in the event that non-compliance occurs.”⁹⁷

Perhaps most importantly, the Company provided no analysis of future greenhouse gas regulations as they relate to the proposed project.⁹⁸ PGE’s agreement with its drilling partner would overlap a period of time when this country will very likely put in place a series of responses to climate change.⁹⁹ Currently, the EPA has issued regulations related to power plants (i.e. Clean Power Plan), and, more recently, methane releases due to natural gas exploration and production.¹⁰⁰ By 2052 it is likely that significant new and additional regulations will be put in place.¹⁰¹ As coal continues to be phased out, it is

⁹³ *Id.* at 19.

⁹⁴ UE 308/PGE/703C, [REDACTED] page 17 (it is a five year drilling program with 30 year production from wells.).

⁹⁵ UE 308 – CUB/200/Jenks/5, lines 3-5.

⁹⁶ *Id.* at 21, lines 17-21; *see* CUB Exhibit 202.

⁹⁷ *Id.* at 22-23; *see* CUB Exhibit 202.

⁹⁸ *See* UE 308 – CUB/200/Jenks/23-24.

⁹⁹ *Id.* at 23, lines 20-22.

¹⁰⁰ *Id.* at 23, lines 22-24.

¹⁰¹ *Id.* at 23, lines 24-25 (2052 is thirty-five years after PGE would initially enter into its partnership, if approved).

likely that natural gas will become the new target of regulatory scrutiny.¹⁰² Entering into a long-term natural gas contract with an uncertain regulatory future is akin to buying a house on a flood plain without taking into consideration the likelihood of a flood. The prudence of an investment is based upon information that the utility knew or reasonably should have known at the time.¹⁰³ The Company should know that an investment such as this carries a significant risk associated with climate change regulations. To enter into this contract without analyzing that risk is imprudent.

ii. Production Risk

Production risk is very real when drilling for natural gas, even when reserves are “proved” and “probable,” as evidenced by the NWN/Encana gas reserves investment.¹⁰⁴ Here, although PGE and its drilling partner agreed to some contract terms designed to reduce this risk, CUB has lingering concerns about the remaining production risk.¹⁰⁵ According to its hedging guidelines, PGE will only enter into drilling operations with “proved” and “probable” reserves.¹⁰⁶ However, the guideline did not contemplate the estimated amount of gas production and reserves, it just spoke in vague terms of “proved” and “probable.”¹⁰⁷ PGE negotiated the current deal, and agreed to the term sheet, without knowing whether the contract met its proposed guidelines.¹⁰⁸ Further, while the contract did have a Condition Precedent requiring Commission approval, it did not require that PGE’s guidelines were met.¹⁰⁹

¹⁰² *Id.* at 24, lines 4-5.

¹⁰³ ORS § 757.355(1); *see, e.g., In re Portland General Electric Company*, Docket No. UE 102, Order No. 99-033 at 36-37.

¹⁰⁴ UE 308 – CUB/200/Jenks/26, lines 19-20.

¹⁰⁵ *Id.* at 26, lines 21-22.

¹⁰⁶ *Id.* at 27, lines 9-10.

¹⁰⁷ *Id.* at 27, lines 14-16.

¹⁰⁸ *Id.* at 27, lines 16-18.

¹⁰⁹ *Id.* at 27, lines 18-19.

PGE reduced the risk of under-production by negotiating a contract with its drilling partner that contains [REDACTED].¹¹⁰ [REDACTED]

[REDACTED].¹¹¹ However, there is still a significant amount of production risk that is borne by customers.¹¹² [REDACTED]

[REDACTED].¹¹³ [REDACTED]

[REDACTED].¹¹⁴ [REDACTED]

[REDACTED].¹¹⁵ One element of production risk is the speed of depletion of the well.¹¹⁶ [REDACTED]

[REDACTED]

[REDACTED].¹¹⁷ While PGE has provided contract terms that reduce production risk, there is still production risk for customers, and that risk increases with every year that PGE elects to conduct more drilling.

iii. Ownership Change Risk

There is a very real risk that PGE’s drilling partner will undergo an ownership change during the contract period, adding further uncertainty to the future of the transaction.¹¹⁸ It is important to recognize that this contract contemplates a thirty-five year relationship, [REDACTED]

¹¹⁰ *Id.* at 28, lines 2-3.
¹¹¹ *Id.* at 28, lines 3-5.
¹¹² *Id.* at 28, lines 16-17.
¹¹³ *See id.* at 28-29.
¹¹⁴ *Id.*
¹¹⁵ *Id.* at 28, lines 20-21.
¹¹⁶ *Id.* at 29.
¹¹⁷ *Id.*
¹¹⁸ *Id.* at 31.

¹¹⁹ [REDACTED]

[REDACTED]¹²⁰ Couple that with the fact that [REDACTED]

[REDACTED] and there is a very real risk that a change in ownership may occur during the contract period.¹²¹

iv. Cost Increase Risk

The contract limits PGE’s capital investment from the first year of drilling, but other costs are not capped.¹²² While the capital investment is shared 50/50, and the gas production is shared 50/50, the operating costs fall more heavily on PGE.¹²³ According to PGE Exhibit 601C, the Company will bear [REDACTED] of the costs for subsequent drilling.¹²⁴ PGE’s drilling partner will operate the drilling program, but PGE will bear the bulk of the costs.¹²⁵ In addition, due to the lack of analysis regarding future carbon/methane regulations, PGE customers will bear a great deal of the costs associated with this risk if they are added to the program.¹²⁶

D. PGE’s Proposed Guidelines for Long-Term Hedging Should be Rejected

PGE’s proposed long-term hedging guidelines are flawed and meeting the guidelines delineated by the Company is not nearly enough to provide a presumption of prudence, as the guidelines state.¹²⁷ PGE’s Four Guidelines are:

Guideline (1): Establish that the “Long-Term Projected Cost” must be at or below the comparable “Long-Term Benchmark Price.”

¹¹⁹ *Id.* at 31, lines 3-4.

¹²⁰ *Id.* at 31, lines 5-6.

¹²¹ *Id.* at 31, lines 24-28, citing [REDACTED]

¹²² UE 308 – CUB/200/Jenks/32, lines 19-20.

¹²³ *Id.* at 32, lines 20-21.

¹²⁴ UE 308 – PGE/601C/Russell – Tooman/3.

¹²⁵ UE 308 – CUB/200/Jenks/32, lines 23-24.

¹²⁶ *Id.* at 32, lines 24-27.

¹²⁷ UE 308 – CUB/100/Jenks – Hanhan/21, lines 14-15; *see* UE 308 – PGE/200/Sims – Outama/2.

Guideline (2): Establish a maximum gas purchase commitment.
Guideline (3): Enter into transactions for properties that contain “Proved Reserves” or “Probable Reserves.”
Guideline (4): Establish limits within which the unit cost of the long-term gas is incorporated into PGE’s annual power cost update (i.e., AUT filing).¹²⁸

There are no guidelines concerning the due diligence PGE should undertake to ensure that there are limited risks to this investment.¹²⁹ There are no guidelines concerning what information PGE needs to document their evaluation of these investments.¹³⁰ There is no guideline addressing that the utility consider other long-term hedges that are not ratebased investments.¹³¹ As addressed in testimony, these guidelines offer little protection to customers, and should be rejected by the Commission.¹³²

E. Approval of PGE’s Proposal May Exceed the Commission’s Statutory

Authority

As a regulatory agency, the Commission is a creature of statute and its authority is confined to what has been expressly conferred by the legislature.¹³³ While the Commission has broad authority “to supervise and regulate every public utility[.]”¹³⁴ it is not without limits.¹³⁵ In asking the Commission to approve an unprecedented request to ratebase the exploration, drilling, and production of natural gas reserves, PGE may be asking the Commission to exceed its statutory authority.

¹²⁸ UE 308 – PGE/200/Sims – Outama/3.

¹²⁹ UE 308 – CUB/100/Jenks – Hanhan/21, lines 25-26.

¹³⁰ *Id.* at 21, lines 26-27.

¹³¹ *Id.* at 22, lines 1-3.

¹³² *Id.* at 22, lines 3-4.

¹³³ *Pac. Nw. Bell Tel. Co. v. Sabin*, 534 P.2d 984, 991 (Or. Ct. App. 1975) (noting that the PUC’s “power arises from and cannot go beyond that expressly conferred upon it.”). *See also* ORS §183.482 8(a)(b)(A) (the court shall remand a Commission order if exercise of discretion was “outside the range of discretion delegated to the agency by law.”).

¹³⁴ ORS §756.040(2).

¹³⁵ *Sabin*, 534 P.2d at 991.

Indeed, in a recent case remarkably similar to the one before this Commission, the Florida Supreme Court reversed the Florida Public Service Commission’s (“PSC”) approval of Florida Power and Light’s (“FPL”) “investments in the exploration, drilling and production of natural gas” reserves.¹³⁶ The court first noted that the legislature has afforded the PSC broad ratemaking authority that encompasses recovery of utilities’ fuel expenses, including the costs of financial derivatives and hedges.¹³⁷ However, the court emphasized that: (1) FPL’s proposal differed drastically from a “hedge” because it authorized FPL to earn a return on the production of an unknown quantity of fuel in the future¹³⁸; and (2) as such FPL’s speculative investment fell “outside the purview of an electric utility as defined by the Legislature.”¹³⁹

As was discussed *supra*, PGE’s ownership, operation, and management of a gas reserve does not constitute a hedge. Moreover, as was true in *Graham*, PGE’s proposed investment expands the statutory activities of a ‘public utility’ that this Commission may oversee without authorization from the Legislature. PGE’s proposal would allow the Company to own, operate, and manage a gas reserve; which contains an unknown quantity of fuel; and authorize recovery of production costs through rates at the Company’s authorized rate of return. Accordingly, PGE’s proposal potentially falls outside the statutorily defined activities of a ‘public utility’ which the Commission is authorized to oversee.

¹³⁶ *Florida v. Art Graham*, 191 So. 3d 897, 899 (Fla. 2016) (describing FPL’s proposal as a joint venture agreement with an independent oil and natural gas company to acquire, explore, drill, and develop natural gas wells in Oklahoma.)

¹³⁷ *Id.* at 901.

¹³⁸ *Id.* (emphasizing that, in contrast to FPL’s proposal, a hedge offers price stability for a specific quantity of fuel for a certain price).

¹³⁹ *Id.* (noting that Florida Statute section 366.02(2) “defines an electric utility as owning, maintaining, or operating an electric generation, transmission, or distribution system.” Compare ORS §757.005 defining a ‘public utility’ as owning, operating, managing, or controlling a plant or equipment “for the production, transmission, delivery or furnishing of ... power.”)

III. Conclusion

For the foregoing reasons, CUB urges the Commission to reject the Company's proposal to ratebase natural gas reserves.

Dated this 3rd day of October, 2016.

Respectfully submitted,

A handwritten signature in blue ink, appearing to read "Michael P. Goetz".

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