

September 21, 2005

Via Electronic Filing and U.S. Mail

Oregon Public Utility Commission
Attention: Filing Center
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Re: In the Matter of PORTLAND GENERAL ELECTRIC
Application for a Hydro Generation Power Cost Adjustment Mechanism
OPUC Docket No. UE 165
In the Matter of PORTLAND GENERAL ELECTRIC COMPANY Application for
Deferral of Costs and Benefits Due to Hydro Generation Variance
OPUC Docket No. UM 1187

Attention: Filing Center

Enclosed for filing in the above-captioned docket are eight copies of the Reply Brief of Portland General Electric for filing in the above-captioned dockets. This document is being filed by electronic mail with the Filing Center.

An extra copy of this cover letter is enclosed. Please date stamp the extra copy and return it to me in the envelope provided.

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

Sincerely,

/s/ DOUGLAS C. TINGEY

DCT:am

cc: UE 165 and UM 1187 Service List

**BEFORE THE PUBLIC UTILITY COMMISSION
OF OREGON**

UE 165 / UM 1187

In the Matter of)
PORTLAND GENERAL ELECTRIC)
Application for a Hydro Generation Power)
Cost Adjustment Mechanism)

**REPLY BRIEF OF
PORTLAND GENERAL
ELECTRIC**

In the Matter of the Application of)
PORTLAND GENERAL ELECTRIC)
COMPANY for an Order Approving the)
Deferral of Costs and Benefits Due to Hydro)
Generation Variation)

INTRODUCTION

Basic ratemaking principles require that rates appropriately match the benefits received with the costs borne by customers. The current treatment of hydro variability in rates does not achieve this principle for various reasons, including the unpredictability of hydro generation, the complexity of its interaction with other utility resources, and the asymmetric impacts of hydro variations. *See* UE 165/PGE/100, Lesh/5-10. Accordingly, PGE and Staff have worked diligently to develop an effective and accurate way to measure the impact of hydro variability and accord proper ratemaking treatment to that variability. The SD-PCAM is not perfect, but is the best and most reasonable choice among alternatives, absent a comprehensive PCA.

Other parties argue there are flaws in the SD-PCAM, but they do not show the mechanism to be unworkable or unreasonable, nor do they demonstrate that their proposed alternatives are not similarly flawed. Continuing to reject attempts to alleviate the impacts of significant hydro generation variations because the alternatives are not perfect simply perpetuates a flawed system. The SD-PCAM is a settlement, and as such, represents an attempt by the parties to compromise and reach a position that is reasonable and fair. The SD-PCAM

also represents an evolution in the Stipulating Parties' thinking about hydro variability that should be lauded. Ratemaking was never meant to be static; to be effective, it must be able to change and react to unanticipated conditions even as the Commission ensures safe and adequate service at reasonable rates. The SD-PCAM is a fair and reasonable means of addressing hydro variability and ensuring a closer alignment of benefits and costs, and as such, it should be approved.

ARGUMENT

I. The SD-PCAM Will Effectively Account for the Cost of Service Impacts of Hydro Variation

The central fact underlying this docket and previous hydro-related dockets is that the cost of service impact of hydro variations is significant and unpredictable. The cost of service impact of hydro variation is the result of two factors, neither of which is under the control of PGE:

(1) water flow during the year, and (2) the market price of power during the year. These variations in water and power costs are not captured by backward-looking normalization and the use of an average water year. The use of these averages results in systematic mismatch of actual and estimated cost. As the Commission noted in UM 1071, some mechanism is needed to account for this ongoing problem, which cannot be solved in a rate case or power cost update such as PGE's RVM.

A. The SD-PCAM Balances Competing Interests in Creating a Mechanism that is Properly Limited to Hydro Variations but is also Accurate

When creating the SD-PCAM, PGE and Staff (the "Stipulating Parties") thoroughly explored the tradeoffs between a comprehensive mechanism that would reflect in cost of service both hydro variations and all other more or less closely related changes in power costs, and mechanism narrowly focused on the cost of service effect of hydro variations that might exclude

very closely related power costs. PGE believes the SD-PCAM represents an appropriate balance of these competing approaches for this docket, with the understanding that this issue will be revisited during PGE's next rate case and a broader power cost adjustment mechanism may be discussed at that time. Lesh/Tinker/PGE/1100/4.

The essence of the SD-PCAM is quite simple. By using Monet, the power cost modeling tool already employed by PGE to set rates in its RVM, the SD-PCAM creates the forecast the Commission would have used to set rates had it known what hydro production would actually be. This mechanism is superior to the simpler method employed by the HGA, which merely valued hydro generation based on market prices. Unlike the HGA, the SD-PCAM accounts for the fact that, on a forecast basis, power costs may decrease with the use or displacement of PGE's thermal resources. The SD-PCAM improves the results of the mechanism for customers because the market price formula of the HGA could represent too high a price for replacement energy or too low a value for resale. The SD-PCAM tracks more variables in order to be more accurate, but stops far short of creating an all-in power cost adjustment.¹

CUB argues that the SD-PCAM is flawed because it does not use actual loads and presumes that purchased energy comes from the day-ahead markets. Limiting the number of variables used to create the SD-PCAM "re-forecast" achieves the objective of limiting the scope of mechanism as much as possible – a position initially advocated by CUB – without sacrificing accuracy.² Using the load forecasted in the RVM is consistent with the SD-PCAM's limited scope that adjusts only those inputs necessary to improve the way PGE reflects its hydro

¹ For example, the SD-PCAM does not include changes to plant availability, new power contracts, or changes in retail load which would be accounted for in an all-in power cost adjustment.

² CUB strongly argued in its opening testimony that "the more narrow the scope of a PCA, the less likely the PCA is to have unintended consequences." CUB/100, Jenks-Brown/21.

resources in cost of service. Finally, the argument that this model assumes imprudent behavior is incorrect – day-ahead prices are not always higher. *See* UE 165/PGE/1100, UM 1187/PGE/200 Lesh-Tinker/13-14. Using day-ahead prices in the SD-PCAM protects customers from the effects of PGE’s power purchase decisions, and thereby concerns of prudence. *Id.*

II. Amortizations of Variances Deferred Pursuant to the Stipulation will be Adequately Reviewed

There has been some confusion over the nature of the SD-PCAM and the deferral requested in the Stipulations. To be clear, the Stipulating Parties have requested that the SD-PCAM become effective on the date of its approval. The Stipulating Parties have requested that the deferral that is the subject of UM 1187, on the other hand, be effective as of January 1, 2005. The deferral requested in UM 1187 is not an automatic adjustment clause, as is the SD-PCAM. The SD-PCAM simply provides a methodology for implementing the deferral. The assertion that the costs to be amortized pursuant to the deferral will not be reviewed is therefore simply incorrect. Amortization of variances incurred and deferred prior to implementation of the SD-PCAM are not “subject to an automatic adjustment clause” and can only take place after review and approval by the Commission. *See* ORS 757.259(5). Adjustments made by a tariff pursuant to the SD-PCAM will also require Commission review and approval even if they are not subject to the hearing procedures of ORS 757.210. As the extensive process and ample opportunity for participation involved in PGE’s annual RVM demonstrates, an automatic adjustment clause can be subject to rigorous review even if formal hearings procedures are not required under ORS 757.210. PGE is confident that the PUC will not approve amortization of charges or refunds it has not reviewed and verified. These several review processes will also provide ample opportunity to review the use of the Monet model for the SD-PCAM, a concern raised by certain parties. The operation of the SD-PCAM will certainly be reviewed and

scrutinized appropriately before any rate changes are implemented by the Commission.

III. Using the SD-PCAM Mechanism to Implement the UM 1187 Deferral will not Require the Commission to Engage in Prohibited Retroactive Ratemaking

A. The SD-PCAM Defers Cost Changes Related to Hydro Variation

As discussed in PGE's Opening Brief and above, PGE and Staff included actual market gas and electric prices in the SD-PCAM in order to make it more accurately reflect the cost of service impact of hydro variation. The cost PGE incurs to replace lost hydro, or receives from sales of excess hydro, is shaped by the economics of dispatching its thermal plants. Excluding this dispatch effect, which requires both market gas and electric prices to calculate, only serves to make the SD-PCAM a less accurate mechanism for measuring what PGE said it wanted to measure in its UM 1187 deferral application: cost of service changes associated with hydro variations.

ICNU's argument that the Commission cannot approve the deferral requested in UM 1187, calculated using the SD-PCAM mechanism, effective January 1, 2005, because it "does more than merely value the hydro generation variances that do occur" ignores this fact and the reality of the interrelated nature of power costs. ICNU Opening Brief at 32. The cost of service effects of hydro variations cannot be found as a line item in an income statement. It must be determined by analyzing a complex matrix of factors. PGE's initial deferral application set forth one method to do that. The SD-PCAM is another. The ability to refine the mechanism by which the goal of a deferral application is satisfied is absolutely within the authority of the Commission under ORS 757.259.

B. PGE's Deferral Application Gave Sufficient Notice to all Parties and Satisfied ORS 757.259

ICNU argues that the costs that will be deferred under the SD-PCAM mechanism were not identified specifically enough in PGE's deferral application to satisfy ORS 757.259. ICNU imputes filing requirements under OAR sec. 860-027-0300(6) into ORS 757.259 to derive a claimed limitation on the Commission's authority to order deferred accounting to those cost or revenue changes narrowly and specifically identified in a deferral application. In fact, ORS 757.259 gives the Commission very broad authority to defer "any increase or decrease in revenues or expenses" and makes no mention of what must be identified in a deferral application. *See* Order 97-180 at 9 (emphasis added). While OAR 860-027-0300(6) provides detail about what should be found in the application, it makes no mention of any limitation on the costs that the Commission can defer based on that application. Given the broad authority delegated to the Commission under ORS 757.259, OAR 860-027-0300 should more appropriately be read as a starting point for the utility to provide detail about its proposed deferral. It is incumbent on a deferral applicant to support its position and prove to the Commission that its deferral is warranted, but it is within the hands of the Commission to determine what items it believes constitute "identifiable utility expenses or revenues, the recovery or refund of which the commission finds should be deferred." ORS 757.259(2)(e). Nothing in the language of ORS 757.259 limits that authority.

ICNU is correct that, as a policy matter, the prohibition on retroactive ratemaking is based in part on a concern that customers have proper notice of what the cost of their utility service will be. ICNU Opening Brief at 26-27. However, the suggestion that the SD-PCAM should not be approved because customers or customer groups have not had sufficient notice is unfounded. ICNU, CUB and Staff have participated through every step of this and previous

hydro deferral dockets.³ The SD-PCAM, in fact, reflects their concerns and criticisms expressed in UM 1187 and UE 165. To suggest that these parties have not had proper notice of the deferral ignores hours of hard work and time expended by PGE, ICNU, CUB and Staff to try to reach agreement on these important issues.

C. UT 135 Is Inapposite to this Case

ICNU's reliance on docket UT 135 and Order 97-180 (May 22, 1997) is entirely misplaced. UT 135 involved a telecommunications utility seeking to recover start-up costs that it claimed it would incur to implement the Telecommunications Act of 1996 ("Act"). UT 135 is easily distinguishable from the instant case for two primary reasons: it involved a different statute (ORS 759.200) from the one applicable here, and the utility did not even apply for a deferral under that different statute.

In UT 135, the Commission found US West Communication's proposed "Interconnection Cost Adjustment Mechanism" ("ICAM") was not legally permissible because it violated the rule against retroactive ratemaking. The utility argued that the Commission could approve the ICAM as a form of deferred accounting pursuant to ORS 759.200. This statute, like ORS 757.259, provides the Commission with authority to issue a deferred accounting order that would otherwise violate the rule against retroactive ratemaking. However, as the Commission pointed

³ It should be noted that the Application in UM 1187 stated that the amount to be deferred would be a function of two unknown and unpredictable variables – hydro generation and market prices. The Application noted that based on a then current river forecast and then current market prices the deferred amount could range from a \$74 million charge to customers to a \$49 million dollar refund to customers. Current projections using the SD-PCAM mechanism are for a much smaller charge, if any, in 2005, suggesting customers did have notice of the amount that would be deferred.

out in Order 97-180:

ORS 757.259 allows the Commission to defer any increase or decrease in revenues or expenses to minimize the frequency of rate changes or to match costs borne and revenues received by ratepayers. In contrast, ORS 759.200(2) provides a detailed list sharply limiting the allowable accounts for which deferred accounting is authorized.

Order 97-180, at 9 (emphasis added). Interestingly, the Commission went to some lengths in Order 97-180 to distinguish the authority granted it under ORS 757.200, which it described as “sharply limit[ed],” and that granted under ORS 757.259, which it described as “broad.”

Order 97-180 at 9, note 8.

The Commission ultimately concluded that ORS 759.200 did not permit the deferral of costs not associated with specific contracts, as US West proposed to do through the ICAM. This holding had nothing to do with the form or content of any application for a deferral by US West and whether the costs sought to be deferred were properly identified in that application. It was simply an interpretation of the scope of the statute, which, as noted above, is more limited and narrow than the statute at issue in the instant case.

The most remarkable fact about this case, which ICNU claims stands for the proposition that it would constitute retroactive ratemaking to “expand the category of costs for which recovery is requested under an application without amending the application” (ICNU Opening Brief at 31), is that US West never made an application for a deferral at all. While ICNU goes to great lengths to emphasize the importance of the form of an application under 757.259, it brushes over that issue when referring to Order 97-180, suggesting in a footnote that US West’s failure to apply for a deferral does not change the nature of the retroactive ratemaking principal. This suggestion directly contradicts ICNU’s argument elsewhere that the Commission’s authority to approve a deferral is based on compliance with a limited statutory exception. US West did not

apply for a deferral and then change the nature of its application, or apply for a deferral and fail to specify which costs it sought to defer: US West never applied for a deferral at all.

Nonetheless, it is interesting that the Commission considered US West's argument that ORS 759.200 should apply to its application for the ICAM rather than rejecting it outright for failure to comply with the procedural requirements of the statute. This consideration suggests that the Commission might have granted the ICAM had it satisfied the statutory requirements, a result directly counter to ICNU's argument.

IV. The Deferral Requested in UM 1187 Should Not be Compared to the Deferral Requested in UM 1071

In UM 1071, the Company sought a single-year deferral for hydro costs. In contrast, the instant case involves a multiple-year mechanism that couples a deferral and an automatic adjustment clause, both of which include a deadband and sharing formula. In addition, Staff and PGE have proposed that the SD-PCAM be viewed as a stepping stone to a permanent solution to the problem of reflecting hydro variability in the cost of service, as the Commission suggested in UM 1071.

ICNU argues that PGE has some knowledge regarding potential hydro conditions in 2006 and suggests PGE has been "gaming the system" by withdrawing a previous hydro deferral request. If ICNU has a crystal ball and knows what hydro will be like in 2006, PGE would dearly like to borrow it. In fact, PGE filed for the HGA in May of 2004 before it had any idea what conditions in 2005 would be like, let alone conditions in 2006. Markets have changed considerably during the pendency of these dockets, and PGE does not know what the outcome will mean for the SD-PCAM in 2005 or 2006.

V. CUB's Proposed Deferral Demonstrates that Its Principle Argument Against the SD-PCAM is Over the Size of the Deadband.

CUB's new proposed deferral demonstrates that CUB has come to agree that the Commission should adopt a power cost adjustment, and that CUB's only principled objection to the SD-PCAM is over the size of the deadband. Because CUB's proposal is far broader in scale than the SD-PCAM, one might assume CUB does not maintain an objection in principle to the scope of the SD-PCAM, and CUB's proposal does nothing to cure the alleged concern over retroactive ratemaking. Instead, CUB simply urges the Commission to adopt a larger deadband and sharing mechanism.

CUB's suggestion that the Commission must adopt its proposed deadband because of past precedent has little support in policy or law. The past 20 years in Oregon have offered many policy choices for the design of revenue/cost deferrals, for PGAs/PCAs, and for automatic adjustment clauses, and even more variation can be found by looking to other states. UE 165/PGE/800, Lesh/10-12. This Commission decided one case and approved settlements using a deadband approach, but none of these previous approaches are directly applicable or can be used as precedent for the instant case.⁴ CUB has gone as far as stating that the type of automatic adjustment clause and the scope of costs included in the automatic adjustment clause do not matter in determining the size of the deadband. That argument is illogical, and its adoption would promote poor regulatory policy.

CUB states no consistent policy or objective it hopes to achieve by through the implementation of its proposed PCA. In contrast, Staff and PGE have crafted a deferral and automatic adjustment clause that meet the policy objectives described in PGE's initial testimony

⁴ These settlements also included a waiver of any earnings test. As just one contrast, the SD-PCAM includes a very tight earnings test.

in UE 165: the SD-PCAM and related deferral will provide rate stability, transparency, and incentives for good management.

CONCLUSION

In its brief CUB expressed its frustration at dealing with the multiple attempts to address the issue of properly reflecting the costs of hydro variation in rates over the past several years. PGE shares that sentiment with CUB. It should be the common goal of all involved in utility regulation to have rates more accurately reflect the costs of providing service. After years of working on this issue, Staff and PGE have agreed on the SD-PCAM mechanism to more accurately reflect the cost of hydro variation in customer rates. The mechanism is in the public interest and should be approved.

DATED this 21st day of September, 2005.

Respectfully submitted,

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CERTIFICATE OF SERVICE

I certify that I have caused to be served the foregoing **Reply Brief of Portland General Electric** in Docket UE 165 and UM 1187 by mailing a copy by First Class U.S. Mail, postage prepaid and properly addressed, and by electronic mail, to the following persons on the combined official UE 165 and UM 1187 service lists maintained by the Commission:

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