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September 21, 2005

Via Electronic and U.S. Mail

Public Utility Commission
Attn: Filing Center
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Re: In the Matter of PORTLAND GENERAL ELECTRIC Application for a Hydro
Generation Power Cost Adjustment Mechanism
Docket No. UE 165

In the Matter of PORTLAND GENERAL ELECTRIC Application for Deferral of
Costs and Benefits Due to Hydro Generation Variance
Docket No. UM 1187

Dear Filing Center:

Enclosed please find an original and six (6) copies of the Reply Brief on behalf of
the Industrial Customers of Northwest Utilities for filing in the above-referenced dockets.

Please return one file-stamped copy of this document in the enclosed stamped
envelope. Thank you for your assistance in this matter.

Sincerely,

/s/ Sheila R. Ho
Sheila R. Ho

Enclosures

cc: Service List

CERTIFICATE OF SERVICE

I HEREBY CERTIFY that I have this day served the foregoing Reply Brief on behalf of the Industrial Customers of Northwest Utilities upon the parties listed below by causing the same to be mailed, postage-prepaid, through the U.S. Mail.

Dated at Portland, Oregon, this 21st day of September, 2005.

/s/ Sheila R. Ho
Sheila R. Ho

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**BEFORE THE PUBLIC UTILITY COMMISSION
OF OREGON**

UE 165/UM 1187

In the Matter of)	
)	
PORTLAND GENERAL ELECTRIC COMPANY)	REPLY BRIEF OF THE INDUSTRIAL CUSTOMERS OF NORTHWEST UTILITIES
)	
Application for Approval of a Hydro Generation Adjustment Tariff.)	
_____)	
)	
In the Matter of)	
)	
PORTLAND GENERAL ELECTRIC COMPANY)	
)	
Application for Deferral of Costs and Benefits Due to Hydro Generation Variance.)	
_____)	

The Opening Briefs submitted by Public Utility Commission of Oregon (“OPUC” or the “Commission”) Staff and Portland General Electric Company (“PGE” or the “Company”) in Dockets UE 165 and UM 1187 do not justify approval of the System Dispatch Power Cost Adjustment Mechanism (“SD-PCAM”) or demonstrate that the Commission can lawfully implement the mechanism retroactively. The Industrial Customers of Northwest Utilities (“ICNU”) urges the Commission to disapprove the stipulations between PGE and Staff (collectively, the “Stipulation”) and reject the SD-PCAM.^{1/} ICNU’s Opening Brief demonstrated

^{1/} PGE and Staff filed two separate stipulations in UE 165 and UM 1187, referred to collectively as the “Stipulation” in this Brief. Attached as Exhibit A to the Stipulation filed in UM 1187 is the UE 165 Stipulation. As such, citations to the “Stipulation” in this Brief refer to the UM 1187 stipulation, with specific reference to the UE 165 Stipulation attached as Exhibit A when appropriate. All other citations in this Brief refer to documents filed in UE 165 unless the citation indicates otherwise.

that authorizing a temporary SD-PCAM is both unwarranted according to the Commission's order in UM 1071 and unlawful according to ORS § 757.259. If the Commission believes that considering a permanent power cost adjustment mechanism ("PCA") for PGE is warranted, then the appropriate forum in which to examine that issue is the rate case that PGE has stated it will file by the end of this year. The Commission should not impose upon customers an inequitable and unproven mechanism such as the SD-PCAM for 2005 and 2006 when doing so will likely ensure that PGE will over recover its power costs over time.

ARGUMENT

1. PGE and Staff Have Not Demonstrated That the SD-PCAM Is Justified According to the Standard Established by the Commission in UM 1071

PGE argues in its Opening Brief that ORS § 756.040 establishes the following "test" for evaluating the SD-PCAM agreed to in the Stipulation:

The commission shall balance the interests of the utility investor and the consumer in establishing fair and reasonable rates. Rates are fair and reasonable for the purposes of this subsection if the rates provide adequate revenue both [for] operating expenses of the public utility . . . and for capital costs of the utility

PGE Opening Brief at 4 (quoting ORS § 756.040(1)). According to PGE, "[if] the Commission concludes that the SD-PCAM produced by the settlement with Staff meets this test, it can and should approve the settlement." Id.

ORS § 756.040 defines the Commission’s general powers; it does not establish the test for evaluating a mechanism such as the SD-PCAM.^{2/} The SD-PCAM essentially is a deferred account disguised as a PCA; therefore, the Commission should apply the standard developed in UM 1071 to determine whether to approve the SD-PCAM. The following factors demonstrate that there is little difference between the SD-PCAM and a deferred account:

- It is a temporary mechanism that will be in effect for a limited and defined time period;
- It has been proposed outside of the context of a general rate case;
- It addresses stochastic risk that has been included in normalized power costs through a one-time deferral;
- It provides for deferral of costs, but provides no mechanism for recovery of those costs;
- The amount of the deferral is calculated by comparing base power costs from the RVM with a projection of actual power costs; and
- The results during the deferral period already are partially known.

In UM 1071, the Commission denied PGE’s request for deferred accounting related to 2003 hydro conditions based on the fact that conditions were not extraordinary enough to justify deferred accounting and because the Company had not suffered a substantial financial impact. Re PGE, OPUC Docket No. UM 1071, Order No. 04-108 at 9 (Mar. 2, 2004) (“Order No. 04-108”). The Commission stated that it evaluates a deferred accounting application according to whether it: 1) meets the requirements of ORS § 757.259; and 2) warrants an

^{2/} Even if ORS § 756.040 did establish the test by which to evaluate the Stipulation, PGE does not quote all of the statute. The two sentences immediately preceding the quote above provide that the Commission “shall represent the customers of any public utility” and “shall make use of the jurisdiction and powers of the office to protect customers, and the public generally, from unjust and unreasonable exactions and practices and to obtain from them adequate service at fair and reasonable rates.” ORS § 756.040(1). In this case, approving the SD-PCAM would be unfair to customers, and it would be unlawful to implement it in the manner proposed in the Stipulation.

exercise of the Commission's discretion because the application is based on a risk that was not considered when the utility's base rates were established or reflects other extraordinary circumstances. Id. at 8-9. The Commission should treat the SD-PCAM as a request for a deferred account and disapprove the mechanism according to this two-pronged standard.

ICNU demonstrated in its Opening Brief that the SD-PCAM does not meet the UM 1071 criteria because: 1) expected hydro conditions for 2005 fall within those modeled in rates; and 2) PGE has not demonstrated a substantial financial impact. Under these circumstances, the Commission should reject the SD-PCAM, or, at least, deny the request to implement the mechanism retroactively.

2. Staff and PGE Provide No Valid Reason to Depart From the Commission's Decision in UM 1071

PGE and Staff both argue that the SD-PCAM deferred account should be approved despite the Commission's order in UM 1071. The Commission summarized its decision in UM 1071 as follows:

Drawing a distinction between stochastic risks that can be predicted to occur as part of the normal course of events and scenario risks that are not susceptible to prediction and quantification, the Commission recognized that hydro variability is included and modeled in PGE's base rates. Further, the Commission found that the 2003 hydro year was within the predicted range of hydro variability. The Commission concluded that a causal event that exists within the range of predicted risk represents a stochastic risk not extraordinary enough to justify deferred accounting unless the financial impact is demonstrated to be substantial. The Commission deemed the impact on PGE's return on equity to not be great enough to warrant a deferral.

Re PGE, OPUC Docket No. UM 1071, Order No. 04-357 at 5 (June 25, 2004).

PGE and Staff attempt to avoid the UM 1071 standard by arguing that the SD-PCAM is ongoing and that the Company has experienced multiple years of below-normal hydro conditions. The SD-PCAM is a temporary, one-time mechanism that addresses stochastic risk, which will result in a mismatch of costs and benefits for customers over time. ICNU Opening Brief at 9-11. In addition, PGE has not demonstrated that it has experienced multiple years of below-normal hydro conditions or shown that it has experienced a substantial impact from such conditions. As such, there is no basis to grant an exception to the UM 1071 standard.

a. A Two-Year SD-PCAM Is Not a “Permanent” or “Ongoing” Mechanism

PGE and Staff both argue that the SD-PCAM is consistent with the Commission’s order in UM 1071 based on the following passage from that order:

We are aware of climate changes and other factors, such as hydro availability, that may affect PGE’s ability to recover its hydro losses. Therefore, although we do not find that this case is appropriate for deferred accounting, we encourage the parties to this docket or other interested persons to present alternatives to deal with hydro variability. For instance, parties might present a PCA proposal similar to the one Staff has outlined here. For the reasons that Staff provides, and that CUB has cited as well, *we believe a PCA may be an appropriate way of permanently allocating risks and benefits of hydro variability between shareholders and ratepayers.*

Order No. 04-108 at 10-11 (emphasis added). Emphasizing the italicized portion of this passage, Staff inexplicably claims that the “Stipulations create precisely the solution contemplated by the Commission in Docket No. UM 1071.” Staff Opening Brief at 9. PGE claims that the Stipulation “is consistent with and implements” Order No. 04-108 and further makes the absurd argument that the SD-PCAM is an “ongoing” mechanism. PGE Opening Brief at 6, 15.

The SD-PCAM will not “*permanently* allocate the risk and benefits of hydro generation.” PGE acknowledges that the SD-PCAM is “not permanent” but argues that the mechanism is nevertheless “ongoing” because it lasts for two years. *Id.* at 15. Part of the Commission’s rationale for denying the deferred account in UM 1071 was that the “cost swings” related to events that reflected stochastic risk would balance out over time but the cost swings related to scenario risks would not. Order No. 04-108 at 9. Authorizing a mechanism such as the SD-PCAM requires a longer timeframe than two years for cost swings to balance out over time. As Staff argued in UM 1071, implementing a temporary power cost recovery mechanism in a below-normal hydro year such as 2005 will only result in a mismatch of costs and benefits to customers over time unless there is a subsequent adjustment to rates in above-normal hydro year. ICNU/402 at 7. Despite Staff’s optimism that “there is a chance in this case that the SD-PCAM may work to customers favor in year 2006,” customers do not even have an equal chance of breaking even over 2005 and 2006 given that it is relatively certain that customers will bear higher costs for 2005, but there is no evidence that above-normal hydro conditions will prevail in 2006. Staff Opening Brief at 11. Considering that normalized hydro conditions are based on decades of hydro data, it seems highly unlikely that risks and benefits would balance out over just two years. The Commission should deny the temporary SD-PCAM because it suffers from exactly the same defects as the temporary deferred account that it rejected in UM 1071.

PGE also argues that the SD-PCAM is ongoing because it is a “stepping stone” to an ongoing mechanism to be addressed in PGE’s upcoming rate case. PGE Opening Brief at 6. Staff calls the SD-PCAM an “interim step to a long-term solution.” Staff Opening Brief at 9. PGE and Staff have not provided evidence that a mechanism similar to the SD-PCAM will be

adopted or even proposed in PGE's general rate case. Staff and PGE have agreed to complete a study of expected value power cost modeling as part of the Stipulation, and the opportunity to conduct this study appears to provide a large part of Staff's rationale for entering into the Stipulation. Regardless of the outcome of that study, however, PGE disagrees with Staff about the use of such modeling. Staff-PGE/100, Galbraith-Tinker/7. Thus, this study is of questionable value, and the assumption that the SD-PCAM sets the stage for a similar, ongoing mechanism is flawed.^{3/} It is more likely that the SD-PCAM is merely a "stepping stone" to further disagreement about expected value power cost modeling.

Staff and PGE both attempt to justify the temporary SD-PCAM based on Mr. Galbraith's statements that Staff entered into the Stipulation because Staff believed "that some sort of supplemental ratemaking is warranted in this case, and that it is unfair to [PGE] to put them between the rock and the hard place of requiring Expected Value Power Cost modeling and saying no to one-time deferred accounting."^{4/} PGE Opening Brief at 16; Staff Opening Brief at 10; Hearing Transcript ("Tr.") at 58:1-7 (Galbraith) (Aug. 9, 2005). To be clear, the only reason for the alleged "rock and the hard place" dilemma is Staff's decision to pursue an expected value power cost modeling mechanism in this Docket. Indeed, Staff initially proposed an interim PCA in UE 165 that did not use expected value power cost modeling. If Staff's position was that merely "some sort" of mechanism was warranted, Staff could have continued to support its

^{3/} The Commission would have to adopt a mechanism substantially similar to the SD-PCAM in PGE's upcoming rate case to give any "ongoing" effect to the temporary mechanism. For example, if the Commission were to adopt a PCA with a \$40 million deadband, as has been adopted or proposed in a number of previous proceedings, this would not achieve an ongoing allocation of costs between PGE and customers because the allocation would be much different than under the SD-PCAM. This likely would result in a permanent mismatch of costs and benefits of hydro production.

^{4/} It is worth noting that Staff's statement acknowledges that a one-time deferred account is the alternative to the SD-PCAM and indicates that Staff would recommend denying a deferred accounting application under the current circumstances.

interim PCA and allowed the Commission to decide the issue. Staff abandoned its interim PCA, however, in favor of the opportunity to immediately implement the SD-PCAM and study expected value power cost modeling. In other words, Staff created the alleged problem caused by requiring expected value power cost modeling but foreclosing other options. It is improper to now use Staff's concern about that position to justify the SD-PCAM.

Regardless of whether waiting to indulge Staff's desire to study expected value power cost modeling would have placed PGE "between the rock and the hard place," approving the SD-PCAM for 2005 will result in customers being charged millions of dollars for additional power costs that PGE would otherwise not be permitted to recover. The theoretical benefit of a \$100,000 study and of Staff avoiding an awkward position of its own creation does not justify approving a temporary mechanism that conflicts with all the relevant PCA criteria and Commission decisions, and that will result in additional costs for customers when circumstances do not warrant rate relief.

b. Unsupported Allegations About a Multiple-Year Hydro Deficiency Do Not Justify Deferred Accounting

PGE also attempts to justify deferred accounting based on the Commission's acknowledgment in Order No. 04-108 that it authorized deferred accounting for Idaho Power when that utility had endured a multi-year drought. Order No. 04-108 at 10. According to PGE, deferred accounting is warranted in 2005 because "hydro conditions have been below normal for five years now." PGE Opening Brief at 17. PGE's claims do not hold water. The Commission specifically found in Order No. 04-108 that PGE did "not face a multiyear drought" as of 2003, and that 2003 hydro conditions did not sufficiently depart from normal to justify deferred

accounting. Order No. 04-108 at 10. PGE's current claim about five straight years of below-normal hydro conditions is inconsistent with the Commission's findings.

In addition, PGE has not provided evidence that hydro conditions over the past five years, or, more importantly, the financial impact of those conditions, justify deferred accounting. The Commission should consider PGE's arguments in terms of the circumstances during this time period.

- For 1995 to 2000, PGE experienced above-average hydro generation for six years in a row. No hydro tracking mechanism or PCA was in place during this period for customers to receive the benefits of above-average hydro.^{5/}
- For January 2001 to September 2001, PGE agreed to and the Commission approved a deferred account that covered the Company's excess power costs.^{6/}
- For October 2001 to December 2002, PGE agreed to and the Commission approved a specific adjustment to rates to account for "adverse hydro conditions" and a comprehensive PCA that was in effect during this period.^{7/} PGE recovered approximately \$38 million under this PCA.
- For 2002, hydro conditions were approximately normal, with runoff at the Dalles at 97% of average.^{8/}
- For 2003, the Commission determined in UM 1071 that hydro conditions were insufficient to justify deferred accounting and specifically found that PGE was not facing a multiyear drought.^{9/}

^{5/} PGE/903, Lobdell-Niman-Tinker/1; Re PGE, OPUC Docket No. UM 1128, Application for Deferral of Hydro Costs and/or Related Revenues at 3 (Dec. 31, 2003); PGE/302, Niman-Tinker/1.

^{6/} Re PGE, OPUC Docket No. UM 1008/1009, Order No. 01-231 (Mar. 14, 2001).

^{7/} Re PGE, OPUC Docket No. UE 115, Order No. 01-777 at Appendix D, p. 14, 18-20 (Aug. 31, 2001).

^{8/} OPUC Docket UM 1187, PGE/100, Dahlgren-Tinker/5. PGE filed a request for a PCA in 2002, but the Company was unwilling to accept a Commission decision on the mechanism and withdrew the filing. Re PGE, OPUC Docket No. UE 137, Letter from Pamela G. Lesh to Vikie Bailey-Goggins (Sept. 13, 2002). Staff had proposed a PCA with a \$39.6 million deadband in that docket that PGE did not agree with. Id.; Re PGE, OPUC Docket No. UE 137, Staff/100, Galbraith/5 (Aug. 16, 2002).

^{9/} Order No. 04-108 at 11.

- For 2004, PGE’s ROE was 10.28%, compared to PGE’s authorized return of 10.5%, indicating that the alleged “multiyear drought” did not substantially affect the Company’s earnings.^{10/}
- For 2005, PGE states that the impact of 2005 hydro conditions is approximately \$17.5 million, and the Company has proposed to recover \$1.97 million of that amount through the SD-PCAM.^{11/}

In light of PGE’s agreement to a PCA and hydro adjustment that determined the appropriate level of excess power cost recovery in 2001 and 2002, and the Commission’s finding in UM 1071 that the Company was not facing a multiyear drought as of 2003, the only years legitimately at issue in this proceeding are 2004 and 2005. The evidence demonstrates that hydro conditions in these years have not had a substantial impact on PGE’s earnings. PGE’s earnings were near normal in 2004. The fact that PGE achieved near normal earnings while the Company was allegedly suffering the effects of a multiyear drought illustrates the danger of allowing cost recovery outside of a general rate case. Even assuming that 2005 hydro conditions have the \$17.5 million impact indicated in PGE’s surrebuttal testimony, this is a one-year impact, and the Commission specifically found a similar amount insufficient to justify deferred accounting in UM 1071. Order No. 04-108 at 9.

In addition, the Commission distinguished Idaho Power from PGE in a number of ways in UM 1071. The Commission specifically pointed out that Idaho Power was “much more dependent on hydro generation than is PGE,” finding that Idaho Power relied on hydro for approximately 66% of its generation while PGE relies on hydro for only 25%. *Id.* at 10. This distinction has not changed. Furthermore, the Commission first authorized deferred accounting for Idaho Power after the utility had experienced six years of full-fledged drought in 1992, and

^{10/} ICNU/403 at 3.

^{11/} PGE/1100, Lesh-Tinker/21-22.

then authorized deferred accounting again in 1994 after eight years of drought. Re Idaho Power Co., OPUC Docket No. UM 480, Order No. 92-1130 at 1 (Aug. 5, 1992); Re Idaho Power Co., OPUC Docket No. UM 673, Order No. 94-1111 at 2 (Jul. 14, 1994). PGE has not even alleged that it has experienced a drought of this duration, much less provided evidence of such conditions. Finally, the Commission found that “the impact of the hydro conditions was much more serious on Idaho Power than on PGE,” noting that the effect on Idaho Power ranged from 675 to 725 basis points of return on equity for two separate years. Order No. 04-108 at 10. PGE has not alleged any financial impact approaching this magnitude. In fact, in UM 1071, the Commission noted that a \$17.5 impact only equated to about 95 basis points for PGE. Order No. 04-108 at 9. There simply is no evidence to authorize deferred accounting for PGE on the basis of the impact of a multi-year drought.

3. Deferrals That Occur When Hydro Generation Is Normal Are Not “Related” to Hydro Generation Variation

ICNU argued in its Opening Brief that the Commission should not retroactively apply the SD-PCAM based on PGE’s UM 1187 deferred accounting Application because they each cover different costs. PGE and Staff both maintain that authorizing deferred accounting for the SD-PCAM based on the UM 1187 Application is permissible because the costs deferred under the SD-PCAM are “related” to the hydro variations that are the subject of that application. The UM 1187 Application requested a deferral to cover only the costs of hydro variation. Thus, the issue is whether it is lawful to adopt a mechanism that will defer costs due to gas and electric price variations when no hydro generation variation occurs at all. There is no reasonable basis to conclude that variations in gas and electric prices that occur when hydro conditions are normal

are the result of, or are related to, hydro generation variation.^{12/} Staff's and PGE's arguments to the contrary are fundamentally unsound.

Both Staff and PGE claim that ICNU has failed to acknowledge the complex relationship between hydro conditions and gas and electric prices. As described below, these claims rely on mischaracterizations of ICNU's position and an overly broad interpretation of ORS § 757.259.

a. The Relationship Between Hydro Conditions and Gas and Electric Prices Does Not Cure the Deficiency in PGE's Deferred Accounting Application

PGE and Staff claim that ICNU's arguments about the SD-PCAM ignore the complex relationship between hydro conditions and gas and electric prices. In fact, however, ICNU's witness explicitly recognized in testimony that: 1) power prices are affected by a host of factors; and 2) the Commission has the discretion to adopt, on a prospective basis, the mechanism that it feels best accounts for that relationship. ICNU/300, Falkenberg/11-12. PGE and Staff both mischaracterize a passage from Mr. Falkenberg's testimony in arguing that "ICNU proposes an 'acid-test' to determine if electric and natural gas prices are sufficiently 'related' to hydro cost variations to be included in the deferral effective January 1, 2005." PGE Opening Brief at 11; Staff/400, Galbraith/9-10. PGE and Staff refer to the following question and answer:

^{12/} Even if there were a basis for such an argument, PGE and Staff have provided no evidence to support a finding that gas and electric price variations that occur under normal hydro conditions are due to hydro variability.

Q. IS IT POSSIBLE THAT THE COMMISSION COULD ACCEPT THE SD-PCAM BECAUSE IT BELIEVED IT WAS A MORE ACCURATE METHOD FOR COMPUTING COSTS DUE TO HYDRO VARIATIONS?

A. Yes. As Mr. Galbraith has pointed out, the Commission could use a different methodology than proposed by PGE to compute costs due to hydro variations. It might even use a method requiring use of the Monet model instead of the Dow Jones index. However, with respect to events that occur prior to any Commission approval of the SD-PCAM or another method, the Commission's discretion should be limited to methods that deal with hydro cost variations alone. While it may not be possible to enumerate all of the methods the Commission might consider, one element must be common to all reasonable methods: *if there is no hydro generation variation between actual and forecast, whatever method used should result in zero deferred costs.* This is an acid test that distinguishes between an allowable method and one that is not allowable for any mechanism that the Commission intends to implement retroactively to January 1, 2005. By Mr. Galbraith's own admission, the SD-PCAM fails to meet this requirement. Instead of allowing deferral of only one cost (hydro variation), the proposal allows deferral of two unrelated costs (gas and power price variations) as well.

ICNU/300, Falkenberg/11; see PGE Opening Brief at 11; Staff/400, Galbraith/9. The "test" discussed by Mr. Falkenberg explicitly refers to determining whether the Commission could lawfully implement a particular mechanism retroactively based on PGE's deferred accounting application in UM 1187. Mr. Falkenberg was merely pointing out that PGE's deferred accounting Application was limited to costs due to hydro variations, thus, a mechanism that produces deferrals during normal hydro conditions cannot be implemented through the Application.

PGE claims that the "SD-PCAM result is absolutely related to variation in hydro generation – it simply provides a more effective methodology for estimating the financial impact of that variation." PGE Opening Brief at 10. There is no dispute that the SD-PCAM can result

in a deferral balance due to variations in gas and electric prices when no variation in hydro generation occurs at all. A mechanism that produces a cost deferral when no hydro generation variation occurs does not more effectively estimate the financial impact of that variation—it tracks and records different costs altogether.

The fact that PGE and Staff have turned the issue of the legal sufficiency of PGE’s Application into a complicated evidentiary question of whether gas and electric price variation is sufficiently “related” to hydro variation only highlights the reasons why the Commission should deny the Application. The Commission has unequivocally stated that that it interprets the deferred accounting statute narrowly and that it will “not grant deferral unless it is clearly within the reach of the statute.” Re PGE, OPUC Docket No. UE 115, Order No. 01-988 at 8 (Nov. 20, 2001); Re PacifiCorp, OPUC Docket No. UE 76, Order No. 92-1128 at 8 (Aug. 4, 1992). If there is any question about whether a deferred accounting application is legally sufficient in terms of identifying and requesting deferral of the relevant costs, then the application should be denied.

b. PGE Requested a “Hydro-Only” Deferred Account in UM 1187

PGE also argues that the SD-PCAM is lawful based on the Commission’s decision in UM 995. PGE Opening Brief at 12 n.6. The Company argues that, in UM 995, the Commission approved recovery of costs related to an outage of PacifiCorp’s Hunter plant through deferred accounting despite the fact that the Hunter outage was not specifically identified at the time of the application. Id.

The application and deferral mechanism at issue in UM 995 were much different than PGE’s Application and the SD-PCAM. PacifiCorp requested deferral of its excess net

power costs in UM 995 based on a mechanism that tracked “the difference between the net power costs implicit in the Stipulation approved by the Commission in [PacifiCorp’s last rate case] and the Company’s actual net power costs during the deferral period.” Re PacifiCorp, OPUC Docket No. UM 995, Application at 1 (Nov. 1, 2000). Unlike the hydro-only mechanism that PGE requested in UM 1187, PacifiCorp’s mechanism arguably encompassed the plant outage that contributed to excess net power costs. In addition, in UM 995, no party raised the issue of whether it constituted retroactive ratemaking to include in the deferred account costs that were outside the scope of PacifiCorp’s application. Thus, that issue was not before the Commission. Nevertheless, as Mr. Falkenberg pointed out, a Wyoming customer group did raise that issue when PacifiCorp requested that the Wyoming Public Service Commission (“WPSC”) authorize deferred accounting to address the high wholesale power costs in 2000-01. ICNU/300, Falkenberg/12-14. The WPSC agreed that including the Hunter costs in the deferred account would constitute retroactive ratemaking, finding that those costs were “not of the same character” as the high market costs that prompted the application and ordering PacifiCorp to exclude those costs from the account. Id.; Re PacifiCorp, WPSC Docket Nos. 20000-EP-01-167, 20000-ER-00-160, Order Granting Motion to Exclude Hunter Generator-Related Costs from Case, ¶ 16 (Nov. 9, 2001).

c. Using Deferred Accounting to Implement the SD-PCAM Does Not Meet the Requirements of ORS § 757.259

PGE correctly points out that the fundamental question with respect to any deferred accounting application is whether it meets the requirements of ORS § 757.259. PGE Opening Brief at 12. If an application does not meet the substantive and procedural requirements in ORS § 757.259, authorizing recovery of the costs at issue constitutes impermissible

retroactive ratemaking. ICNU demonstrated in its Opening Brief that authorizing deferral according to the SD-PCAM methodology would not meet either the substantive or procedural requirements of ORS § 757.259.

PGE's Application requested deferred accounting on the basis that it would "match appropriately the costs borne by and benefits received by ratepayers" under ORS § 757.259(2)(e). OPUC Docket No. UM 1187, Amended Application at 2. Authorizing the temporary SD-PCAM in a below-normal hydro year such as 2005 likely will result in a mismatch of costs and benefits over time, because there is no assurance that a similar adjustment will be made to rates in a future, above-normal hydro year. ICNU Opening Brief at 9-11. In addition, neither the Stipulation nor the SD-PCAM itself provide any indication when any amounts under the mechanism will be charged or credited to customers. As a result, there is no basis to conclude that the SD-PCAM will match ratepayer costs and benefits because there is no indication which customers will bear those costs and in what timeframe.

In addition, PGE's Opening Brief describes deferred accounting in a manner that essentially eliminates from ORS § 757.259 and the Commission's rules all procedural requirements for deferred accounting applications. PGE Opening Brief at 13-14. Under PGE's interpretation, a party could file a generic deferred accounting application, interested parties could provide input on the costs to defer under that application, and the Commission would have discretion to determine which costs to defer. Id. This type of generic and open-ended deferred accounting would result in impermissible retroactive ratemaking.

The deferred accounting statute provides that the amounts at issue must be "identifiable" and the OPUC rules require an applicant to include a description of the costs at

issue in the application. ORS § 757.259(2)(e); OAR § 860-027-0300(3)(a), (6)(b). Taken together, these requirements reflect the intent that the costs at issue be specifically identified in the application. As ICNU described in its Opening Brief, part of the function of the deferred accounting application is to provide notice of and identify costs that the utility is seeking to include in rates when recovery would otherwise be impermissible due to the rule against retroactive ratemaking.

Under PGE's interpretation, the Commission would have broad discretion to determine the costs to defer based on the arguments of the parties, but customers would never really have notice of the particular costs at issue, because those costs could change based on the ultimate decision. PGE argues that it is a "gross exaggeration" for ICNU to claim that use of deferred accounting in this manner could allow deferral of distribution costs based on an application to defer unrelated storm damage costs, but the Company's description of the policy reasons supporting its broad interpretation reveals no limitations:

If the Commission and the utility were bound by the costs identified in the original application, the input of Commission Staff and Intervenors would necessarily be limited to a consideration of the utility's original proposal, and the Commission would lack the authority to create a deferral that is best suited to achieve the statutory objectives identified at ORS 757.259(2)(e) and ORS 756.040.

PGE Opening Brief at 13-14. Authorizing deferred accounting should absolutely be "bound" by the costs for which an application is submitted because deferred accounting is a narrow exception to the rule against retroactive ratemaking. Again, deferred accounting is unlawful outside the narrow confines of ORS § 757.259. Under ORS § 757.259(2), deferred accounting may be authorized "[u]pon application of a utility." The whole process for granting approval to

defer costs under ORS § 757.259(2) is based on, and limited by, the application. The Commission has ample discretion to authorize deferral of costs to achieve the relevant statutory objectives, but it lacks authority to authorize deferral of costs for which a valid application has not been submitted. There is no basis to conclude that an application that does not identify certain costs seeks authority to defer those costs.

The fact that PGE amended its application in UM 1187 reflects the Company's recognition of the importance of a validly filed application. PGE originally requested a deferred account to implement the Hydro Generation Adjustment ("HGA") tariff that the Company initially proposed in UE 165, but the Company later amended that Application to request deferred accounting regardless of whether the Commission approved the HGA. If the only concern under the statute were, as PGE contends, creating a deferral that best served the Commission's statutory objective of balancing the interests of customers and the Company under all circumstances, it should not matter what basis the Company stated for deferral. The Commission would be able to take that application and mold it to defer the costs that it saw fit. The Commission has not applied such a broad interpretation of the deferred accounting statute in the past, and it should reject that interpretation in this proceeding. Deferred accounting is an extraordinary remedy, and the statutes, rules, and Commission decisions regarding the practice all reflect the importance of a validly filed application.

4. The SD-PCAM Was Developed Without Customers' Input and Does Not Address ICNU's Concerns

Staff and PGE also both argue that the SD-PCAM should be approved because it addresses concerns expressed by ICNU and CUB in direct testimony. PGE Opening Brief at 5-7; Staff Opening Brief at 12. The record should be clear that the SD-PCAM was developed without

participation by ICNU, and PGE and Staff agreed to the mechanism after seeking only minimal input from customer groups. The Stipulation and the SD-PCAM do not satisfy ICNU's concerns.

a. There Is No Evidence That the Efforts to Consider Thermal Dispatch in the SD-PCAM Result in a Better Mechanism

PGE and Staff both argue that the SD-PCAM addresses concerns that the HGA originally proposed by PGE did not take into account the dispatch of the Company's thermal plants. PGE Opening Brief at 6; Staff Opening Brief at 12. First, given that no party has been able to scrutinize the completed mechanism, there is no basis to conclude that it accurately reflects the dispatch of PGE's thermal plants. Second, the evidence provided by PGE indicates that Monet actually is a poor predictor of changes in gas-fired production. ICNU/300, Falkenberg/32. As a result, even though the SD-PCAM represents a change from the HGA, it is not necessarily a step in the right direction.

In addition, although the SD-PCAM may attempt to account for thermal dispatch, it does so at the expense of abandoning a "hydro-only" mechanism. Tracking gas and electric price variation under the SD-PCAM goes far beyond the scope of PGE's original proposal, but the mechanism's deadband is significantly smaller than any PCA that the Commission has approved in the past. Staff argues that the smaller deadband is acceptable because the SD-PCAM is not a comprehensive PCA; however, ICNU demonstrated in its Opening Brief that the cost variations that the SD-PCAM does take into account—hydro variability and fluctuations in wholesale gas and electric prices—are primary factors contributing to PGE's overall power cost variability. Staff Opening Brief at 10; ICNU Opening Brief at 12. The tradeoffs made to reach agreement on the SD-PCAM are unacceptable and should not be approved.

b. The SD-PCAM's Earnings Test Undermines the Benefit of the Asymmetric Deadband

Staff argues that the SD-PCAM is designed to address concerns about the symmetrical deadband in PGE's HGA. Staff Opening Brief at 12. Staff points out that the SD-PCAM has an asymmetrical deadband; however, the reality is that the SD-PCAM's earnings test likely will eliminate much of the benefit of that asymmetry. Staff's Opening Brief described the SD-PCAM's earnings test as follows:

In addition to the deadband and sharing, PGE's recovery of the annual SDCV is limited by an earnings test. Under the Stipulations, recovery of any deferred amounts will be limited to those that result in PGE earning no greater than a 10.5% ROE on a regulated basis. All deferral amounts that result in PGE earning an ROE that exceeds 10.5% on a regulated basis will be written off.

Staff Opening Brief at 4. Staff omits from this description the other half of the SD-PCAM's earnings test, which provides that customers do not receive any benefit of reduced power costs (i.e., a deferral of power cost savings), unless PGE is earning greater than a 10.5% ROE. Indeed, just as PGE will not recover costs that would result in the Company earning in excess of 10.5% ROE, the Company will not credit any savings to customers that would result in earnings below 10.5% ROE, and PGE will retain the excess savings.

Including a symmetrical earnings test in the SD-PCAM undermines the effect of the asymmetric deadband, because it likely will result in customers bearing costs that are disproportionate to the savings received. Although a number of complex and interrelated factors affect PGE's earnings, it is apparent that the SD-PCAM earnings test will offset the benefit of the asymmetrical deadband even if only the earnings impact of power cost variation is considered. The Stipulation provides that "actual power costs" will be used for purposes of the

earnings test. Stipulation at Exhibit A, p. 4. As a result, if Updated Power Costs under the SD-PCAM exceed Base Power Costs, the \$15 million that PGE will bear under the SD-PCAM deadband will be taken into account in determining whether PGE has earned less than the 10.5% ROE earnings target that allows amounts to be collected from customers. If PGE has absorbed \$15 million in power costs for the year, it is unlikely that its earnings will be above 10.5% ROE. In UM 1071, for example, PGE alleged that it had incurred \$31.6 million in excess power costs in 2003, and the Company claimed that its ROE would reach only 9.75% even if it recovered all of the excess costs. Re PGE, OPUC Docket No. UM 1071, Opening Comments of PGE at 1, 3 (Jan. 9, 2004).

In contrast, if Updated Power Costs are less than Base Power Costs, PGE will retain \$7 million under the SD-PCAM deadband prior to applying the earnings test. Retaining \$7 million in power costs is unlikely to result in earnings in excess of 10.5% ROE for PGE. As a practical matter, the chances of PGE earning in excess of its authorized ROE are less than achieving earnings below that level. PGE has indicated repeatedly in the multiple requests that it has filed for PCAs and hydro-related deferrals in recent years that its earnings are consistently below its authorized ROE. Even the 10.28% ROE that PGE earned in 2004, which is far from a dire figure, would be insufficient to trigger any cost savings being returned to customers under the SD-PCAM. Thus, the SD-PCAM's earnings test likely will limit any credits to customers despite the mechanism's asymmetrical deadband.

CONCLUSION

PGE and Staff have not justified approval of the SD-PCAM. The mechanism conflicts with the Commission's decision in UM 1071, as well as Staff's previously stated

criteria for a PCA. In addition, PGE and Staff request that the Commission implemented the SD-PCAM in a manner that constitutes retroactive ratemaking. PGE and Staff have provided no basis to approve the SD-PCAM or a deferred account based on the impact of a multi-year drought on PGE, and there is no evidence (or even a completed mechanism) upon which to base a finding that the SD-PCAM improves on past proposals and will equitably allocate costs between PGE and customers. The Commission should disapprove the temporary SD-PCAM in order to avoid allocating to customers a disproportionate share of power costs during 2005 and 2006. The only appropriate place to examine whether to implement an ongoing PCA mechanism for PGE is in PGE's upcoming general rate case.

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Respectfully submitted,

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