Portland General Electric Company
Legal Department
121 SW Salmon Street • Portland, Oregon 97204
(503) 464-7611 • Facsimile (503) 464-2200

Richard George
Assistant General Counsel

May 31, 2007

Via Electronic Filing and U.S. Mail

Oregon Public Utility Commission
Attention: Filing Center
550 Capitol Street NE, #215
PO Box 2148
Salem OR 97308-2148

Re: UM 1276 – INVESTIGATION INTO PERFORMANCE BASED RATE MAKING MECHANISMS

Attention Filing Center:

Enclosed for filing in the captioned dockets are an original and one copy of:

- **OPENING COMMENTS OF PORTLAND GENERAL ELECTRIC COMPANY**

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.

Sincerely,

J. RICHARD GEORGE

JRG:jbf
Enclosure

cc: Service List-UM 1276

CERTIFICATE OF SERVICE

I hereby certify that I have this day caused the following **OPENING COMMENTS OF PORTLAND GENERAL ELECTRIC COMPANY** to be served by electronic mail to those parties whose email addresses appear on the attached service list, and by First Class US Mail, postage prepaid and properly addressed, to those parties on the attached service list who have not waived paper service.

Dated at Portland, Oregon, this 31st day of May 2007.

J. RICHARD GEORGE

Susan K. Ackerman, Attorney Susan.k.ackerman@comcast.net	John DeMoss Agent for PTW turbineone@earthlink.net
Ann L. Fisher AF Legal and Consulting Services energlaw@aol.com	Kimberly Perry McDowell and Rackner kim@mcd-law.com
Lisa F. Rackner McDowell and Rackner lisa@mcd-law.com	Lowrey R. Brown Citizens Utility Board of Oregon lowrey@oregoncub.com
Jason Eisdorfer Citizens Utility Board of Oregon Jason@oregoncub.com	Robert Jenks Citizens Utility Board of Oregon bob@oregoncub.com
Melinda J. Davison Davison Van Cleve 333 SW Taylor, Suite 400 Portland, Oregon 97204 mail@dvclaw.com	Michael T. Weirich Assistant Attorney General Regulated Utility and Business Section 1162 Court Street NE Salem, Oregon 97301-4096 michael.weirich@doj.state.or.us
Karl Bokenkamp Idaho Power Company kbokenkamp@idahopower.com	Ric Gale Idaho Power Company rgale@idahopower.com
Sandra D. Holmes Idaho Power Company sholmes@idahopower.com	Barton L. Kline Idaho Power Company bkline@idahopower.com
Lisa D. Nordstrom Idaho Power Company lnordstrom@idahopower.com	Gregory W. Said Idaho Power Company gsaid@idahopower.com
Steven Weiss Northwest Energy Coalition steve@nwenergy.org	Robert D. Kahn NW Independent Power Producers rkahn@nippc.org
Michelle R. Mishoe Pacific Power and Light michelle.mishoe@pacificorp.com	Natalie Hocken PacifiCorp Natalie.hocken@pacificorp.com
Oregon Dockets PacifiCorp oregondockets @pacificorp.com	Randall J. Falkenberg RFI Consulting, Inc. PMB 362 8343 Roswell Road Sandy Springs, GA 30350 consultrfi@aol.com
Steve Chriss Public Utility Commission of Oregon PO Box 2148 Salem, Oregon 97308-2148 steve.chriss@state.or.us	John W. Stephens Esler Stephens and Buckley stephens@eslerstephens.com

Ann English Gravatt Renewable Northwest Project ann@rnp.org	

BEFORE THE PUBLIC UTILITY COMMISSION

OF OREGON

UM 1276

In the Matter of PUBLIC UTILITY COMMISSION OF OREGON Staff Request to Open an Investigation Related to Performance-Based Ratemaking for the Elimination of the Build-vs-Buy Bias.	**Opening Comments of Portland General Electric Company**

The Commission opened this docket in August 2006 to investigate methods that could be used to eliminate a perceived utility bias towards building resources rather than purchasing power. One of the starting premises in this docket is that the bias is postulated to exist under the current cost-of-service regulatory framework because a utility has an opportunity to earn a return on owned resources but does not on purchased power contracts. Additionally, credit rating agencies, such as Standard and Poor's (S&P) and Moody's, consider purchased power agreements (PPAs) long-term commitments that have debt-like obligations. They then impute debt to the utility's balance sheet to capture the effect of these long-term financial obligations.

One benefit of reducing or eliminating any perceived bias should be an increase in wholesale power competition as utilities purchase more power. This increased wholesale power could come from additional resources, which would lead to a healthier and more robust wholesale power market. Increased competition would also provide more optionality. This optionality, and flexibility, puts downward pressure on power costs and may help to keep rates lower than otherwise. To affect utility behavior, and "level the playing field" between owned resources and purchased power contracts, the various parties developed straw proposals to encourage more competition in the current regulatory framework and to help mitigate any perceived build-vs-buy bias.

PGE submitted three “straw” proposals for consideration: 1) Debt Imputation Offset, 2) Income Opportunities with Contracts, and 3) Income Opportunity by Portfolio. These proposals were filed with the Commission on May 16, 2007. We do not believe that these straw proposals are mutually exclusive. The Commission could use one of these proposals along with or even parts of another proposal.

The Debt Imputation straw proposal would offset imputed debt by imputing an equal amount of equity. The debt imputation offset would be incorporated during a general rate case proceeding, and would provide recovery during the same time period as that used in S&P’s imputed debt calculation. The calculation would be based on the contracts included in the utility’s power cost forecast for the test year. The calculation would follow the S&P methodology and would be subject to audit and review by OPUC Staff and other parties. Debt imputation by the financial rating agencies creates a bias towards building rather than buying. Removing the bias helps encourage utilities to enter into more contracts.

The Income Opportunities with Contracts straw proposal seeks to eliminate any utility bias by allowing the utility to receive an adder on each mid- to long-term purchased power contract. The amount of the adder would depend upon the contract type, duration, and the level of oversight required to manage the contract. For contracts that are longer duration and/or require more management (e.g., medium term tolling), the adder would be larger.

Income Opportunity by Portfolio, on the other hand, helps to mitigate any build-vs-buy bias by compensating the utility with a management fee on their contract portfolio. A portfolio management fee concept is similar to the management fee of a mutual fund or that of an actively managed stock portfolio. The management fee compensates the utility for effectively managing its performance in providing safe, reliable power at a reasonable price and for the earnings opportunity loss from not building. The management fee would be structured as a percentage of the net cost of contracts that are held by the utility.

The income opportunity proposals are effective at changing utility behavior because they address the absence of earnings potential that exists with purchased power. Utilities would be able to compare contracts and owned resources based upon their characteristics and how to best serve load, while lessening the focus on earnings, shareholder value, and rate impact. Rates may increase in the short run with these methods, but greater demand for purchased power will create more competition. This should lead to a healthier and more robust power market. Increased competition can then elicit market efficiency and cost savings, which ultimately helps to reduce costs in the long run.

Along with removing the bias towards building resources rather than purchasing power, PGE believes that the straw proposals must be evaluated on criteria that are relevant and meaningful to the overall intent of the UM 1276 docket. PGE established the following criteria/questions that each proposal should meet or answer:

Evaluation Criteria:

a. Is the proposal (i) understandable, (ii) computable, and (iii) verifiable?

b. Is the proposal effective at removing real or perceived bias? Some questions that are helpful in making this determination are:

    i. What behavior or decisions does the proposal reward?

    ii. What behavior or decisions does the proposal penalize?

    iii. What effect does the proposal have on electric rates in the long-term?

    iv. Will implementing the proposal have unintended effects on other explicit or implicit parts of the overall regulatory framework?

c. Does the proposal adequately consider financial market practices and interpretation?

d. Is the proposal within the Commission's current authority?

e. Can the proposal be combined with another proposal?

PGE believes that its straw proposals all meet these criteria. The debt imputation proposal uses the methodology used by S&P. It is understandable, computable, and verifiable. It also directly considers and implements financial market practices. The proposal is a straight-forward recognition in rates of a cost that is incurred. It neutralizes the financial impact of rating agency debt imputation for power purchase contracts. Recognizing such costs in utility rates is well within the Commission's authority and practices. And since the Debt Imputation proposal only addresses the negative financial impact on a utility and its credit rating from power purchase contracts, it can, and should, be used in conjunction with other proposals or approaches that address the earnings bias toward building.

The income opportunity proposals address that earnings bias. They both can be implemented in a way that is understandable, computable and verifiable. By allowing an opportunity for utilities earnings on power purchase contracts, either contract specific such as under the Income Opportunities for Contracts, or portfolio specific as under the Income Opportunities by Portfolio proposal, the earnings bias toward company-owned resources is lessened or removed.

What is the effect on rates of these proposals? One of the questions proposed by PGE in determining whether a proposal is effective in removing the bias is what effect the proposal has on electric rates. The Debt Imputation proposal would directly offset costs that the utility is incurring indirectly, and thus is neutral to ratemaking in the long run. The Income Opportunities proposals would raise power costs in the short-term to the extent of the earning potential of the utility. However, as discussed above, an expected benefit of reducing or eliminating a bias toward building is increased competition in the wholesale market leading to lower rates in the long-term. So, in the long term, these proposals are expected to lead to lower power costs.

Of PGE's straw proposals, PGE believes implementation of the Debt Imputation proposal is the minimum that should be done in this docket. It addresses and neutralizes a known and measurable financial impact on utilities from power purchase contracts. It does not, however, address the earnings bias toward company-owned generation. For this reason, PGE suggests that the debt imputation can effectively be used along with the

Income Opportunity or other proposals to address the real or perceived bias toward building.

Other Straw Proposals: Straw proposals were also circulated from ICNU, NIPPC and PacifiCorp. PGE offers these brief comments on those proposals:[1]

ICNU proposal: ICNU's Return on Equity Adjustment Straw Proposal is more of an un-proposal than a proposal. Under ICNU's approach, if the Commission provided any income incentive to a utility, then the Commission should reduce the utility's ROE by an equivalent amount. The example ICNU gives is of the Commission "reducing the utilities' overall ROE by an amount that would be equivalent to the additional income the utility expects to obtain during the test period in which the power purchase agreements would be included in rate base." In other words, the Commission should, through an ROE adjustment, take away whatever incentive is given to a utility to enter into power purchase agreements. That would not only be not effective in removing any bias, but it would render whatever else the Commission did to remove any bias ineffective.

ICNU's proposal is also based on a faulty assumption that any incentives to eliminate this bias would shift risk from the company to customers. However, the theory behind this docket is that reducing or eliminating this bias would increase wholesale competition and lead to lower rates in the long term. We do not understand how that shifts risk to customers. ICNU may be assuming that power purchase contracts are less risky than company owned generation. That is certainly not the case across the board – and PGE's Mid-C contracts are a good example of that. The power supply and cost variation risks imposed on the company by those contracts, which have been the subject

[1] ICNU filed its straw proposal with the Commission. NIPPC and PacifiCorp did not. Because they have not been filed with the Commission, copies of the NIPPC and PacifiCorp straw proposals are attached to these comments.

of other proceedings, can be significantly greater than those of company-owned generation.

The ICNU proposal has unintended consequences. Systematically lowering Oregon utilities' ROE could make them less attractive investments, and make it more difficult and costly for utilities to raise capital. Rather than being cost neutral, the ICNU proposal could lead to higher costs for customers in the long run.

ICNU's proposal does not constructively address the issue that is the subject of this docket, and should not be implemented.

NIPPC Proposal: NIPPC's proposal has two parts. The first part is to change the RFP evaluation process by applying a 10% discount to the net present value of the power in an independent power producer's (IPP) bid. NIPCC states that this discount "is recognized for bid evaluation purposes only, and does not either reduce payments to the IPP or get reflected in consumer rates." PGE does not agree with this proposal. Applying an artificial discount to contracts to skew the analysis does not change the real costs of the contracts that will be borne by customers. Whatever benefits the contract will provide will be part of any RFP analysis, but intentionally skewing the analysis in favor of IPP contracts will not lead to the best decision making, or the lowest costs for customers. Such an approach also gives no incentive to a utility to enter into a PPA rather than build; it merely skews the analysis. As such, this approach does not meet the most fundamental criteria suggested by PGE – it is not effective in eliminating any bias. It also has a significant potential to lead to power costs that are higher than they otherwise would be if actual costs were used in the analysis.

The second part of NIPCC's proposal is its stated openness to pursuing the PacifiCorp straw proposal approach of "rate basing" PPA capacity payments. NIPPC discusses certain timing and ratemaking aspects of that proposal, and states that it remains interested in pursuing such incentive mechanisms. PGE is also interested in continuing the discussion of that or similar proposals.

PacifiCorp Proposal: PacifiCorp's straw proposal is that PPA incentives should be based on principles established by Oregon's past conservation incentives, treating PPA's similarly to how demand side management costs were treated. Under PacifiCorp's proposal, utilities would capitalize expenditures for the capacity portion of new PPAs that are one-year or longer in duration. The calculation would be performed using the same NPV calculation that S&P uses in imputing debt related to PPAs. Allowance for Funds used for PPA's (AFPPA) would be recognized in the calculation. Then, in a rate case or annual power cost update, utilities would amortize prudent PPA capacity expenditures, plus AFPPA, over the life of the PPA. Utilities would earn a return on the unamortized capacity portion of the PPA. PPAs would, of course, be subject to a prudence review.

PGE believes that this proposal deserves further exploration. It meets the criteria proposed by PGE. It would encourage utilities to pursue cost-effective PPAs leading to increased wholesale competition. It is also consistent with past and current ratemaking practices.

In further discussion of this proposal PGE raises the following questions:

(1) Can the mechanism be designed in a way that is understandable, computable and verifiable? Or put another way, can it be designed in a way that will not lead to dispute over the treatment of each new contract.

(2) Should existing contracts be included? If the answer is "no," there is not an incentive for a utility to keep existing PPAs. The effect of only including new contracts is a phase-in of the mechanism as existing contracts expire. This will not line up with how financial markets will look at utilities and their supply portfolios.

(3) Should the type and duration of contracts included in this mechanism be the same as the type and duration of contracts that will be used in the debt imputation calculation by S&P? If there is an identified group of contracts that is specifically considered by the financial markets, is there a reason to not use the same group in this mechanism?

CONCLUSION

There has been a significant amount of thought and work put into this docket by the various parties. Parties held several workshops that were successful and productive. Parties have had good discussions, during which we refined ideas and proposals that have furthered the purposes of this docket. PGE looks forward to continuing those discussions, and receiving input from the Commission in the upcoming workshop.

DATED this 31st day of May 2007.

Respectfully submitted,

/s/ J. Richard George

J. RICHARD GEORGE, OSB No. 97469
Portland General Electric Company
121 SW Salmon Street, 1WTC1300
Portland, OR 97204
Telephone: 503-464-7611
Fax: 503-464-2200
E-Mail: richard.george@pgn.com

S:\RATECASE\OPUC\DOCKETS\UM-1276 (build vs buy)\5-31-07 Opening Comments\UM 1276 Opening Comments.doc

UM 1276

NIPPC Straw Proposal
May 16, 2007

NIPPC proposes the following approach for removing utility bias in favor of resource ownership.

1. Re-open UM 1182 to provide that, in RFP evaluations, the positive benefits that IPPs provide to consumers in the form of risk avoidance is explicitly recognized. These risks were described in NIPPC's April 19, 2007, Straw Proposal. The benefits ratepayers receive can be recognized by applying a 10% discount to the net present value of delivered power of any IPP bid in the RFP as evaluated by the utility and the Independent Evaluator. (The definition of "delivered power" may vary by resource type.)

The discount is recognized for bid evaluation purposes only, and does not either reduce payments to the IPP or get reflected in consumer rates. The chosen discount, 10%, is reasonable because (a) it would be impossible to precisely quantify in advance the risk absorption benefits IPPs bring to utilities and consumers, and (b) a 10% discount has been used before in the Pacific Northwest to recognize the value of alternative resources such as conservation and QF purchases. The Accion-Boston Pacific IE Report on PacifiCorp's recent RFP recommended that these IPP risk avoidance attributes be recognized by requiring the utility to live with its "benchmark bid" as IPPs are. While NIPPC prefers this approach as well, NIPPC does not recommend it here because such an approach is unlikely to find a place in Oregon policy.

2. NIPPC is open to using the PacifiCorp approach to "rate basing" PPA capacity payments, as described in the utility's April 19 proposal, if pre-conditions are met. These pre-conditions would be aimed at assigning risks of an IPP contract as follows:

- Unit availability of the generator is pre-selected at an annual (percentage) level
- Significant construction risks are assumed by the IPP
- O&M cost risk is assigned the IPP
- The IPP must ensure that relevant permitting requirements have been properly met

Rate basing the capacity portion of an IPP contract also entails other considerations. Capitalization is usually conducted through rate cases. If rate cases are spread out across time, one consideration is whether rate basing sends appropriate price signals to customers. If the utility does not either file for frequent rate cases or has some regulatory vehicle through which the capacity values of the IPP contracts can be updated, the amount of capacity value actually rate based may not reflect the true value of the cost incurred to the utility for engaging in the contracts. This frequency issue could be resolved by an annual adjustment vehicle. Additionally, failure to adequately adjust capacity values could raise debt imputation issues if the utility signed new IPP contracts but did not have a regulatory vehicle through which their overall long-term debt is updated to reflect such actions.

PacifiCorp suggested in its April 19 paper that additional incentive mechanisms could be linked to the concept of rate basing the capacity portion of the IPP contracts. NIPPC remains interested in incentive mechanisms that are well designed, equitable to all parties, and contain a substantially high probability of success. We therefore encourage PacifiCorp to continue a dialogue on such items.

3. Both the 10% discount used for IPP bid evaluation purposes and the ability of the utility to earn a utility rate of return on PPA capacity payments has value to consumers because together these mechanisms provide the utility (and thus consumers) with an incentive to acquire IPP resources in the near- to mid-term. By enabling the utility to enter into PPA transactions of varying resource type and duration, utilities and their ratepayers can effectively benefit from a diverse portfolio of least-cost resources that can satisfy their needs with reduced risk.

4. Whatever regulatory construct the Commission adopts should be reviewed after five years to assure it effectively addressed the utility self-build bias while providing consumers with minimal risk and thereby more affordable electricity.

Incentives for New PPAs Based Upon Oregon Conservation Incentive Model CIM/pp (Conservation Incentive Model for Purchased Power)

Concept: Incent Oregon utility acquisition of new PPAs by applying Oregon's model for conservation incentives, treating PPA capacity costs similarly to DSM costs.

Background: The Commission issued a series of orders in the late 1980's and early 1990's designed to encourage utility DSM expenditures by allowing comparable rate treatment for supply-side and demand-side costs. The goal of PPA incentives is similar, in that they are designed to allow comparable regulatory treatment of two types of supply-side resources.

To remove the disincentive to invest in new DSM, the Commission allowed capitalization of all DSM expenditures (both capital and expense). The Commission also allowed amortization of these costs, with a return, over the life of the DSM program. *See In re PacifiCorp and PGE Conservation Program Expenses*, Order No. 89-1700 (1989). In this manner, the Commission established comparability between utility expenditures in DSM and utility investment in new generation plant.

The Commission recognized, however, that eliminating the disincentive to invest in DSM was insufficient to change utility behavior because this, at best, left utilities indifferent. Thus, the Commission also allowed utilities to seek additional incentives to make DSM expenditures more attractive than traditional supply-side investment. The Commission decided that these incentive mechanisms should be, at least to some degree, utility specific because a mechanism can only function as an incentive if the entity sought to be encouraged views it as such.

The Commission gave five specific policy goals for these additional incentive mechanisms: (1) symmetrical rewards and penalties; (2) specific benchmarks; (3) proportionate rewards/penalties; (4) significant but not excessive incentives; and (5) savings should be based on best estimates and not subject to after-the-fact true-up adjustments. *In re Electric Utility Incentives for Acquisition of Conservation Resources*, UM 409, Order No. 92-1673 (1992).

Proposal:

- Allow utilities to capitalize expenditures in capacity portion of new PPAs of one-year or longer in duration. Utilities should derive the capitalized amount by determining the net present value (NPV) of PPA capacity payments from contract inception through termination. Utilities should use the same NPV calculation that S&P now uses in imputing debt related to PPAs, which applies a discount rate based on the utility's average cost of debt.

- Where a PPA does not have an identifiable capacity component, use the current S&P method for determining a proxy capacity component. In any event, the capacity portion of a PPA shall be capped at 50% of the total PPA costs.

- Recognize AFPPA (Allowance for Funds used for PPAs), using the utility's AFUDC rate calculated on a post-tax basis, for capitalized portion of new PPAs before costs are reflected in rates.

- In rate case or annual net variable power cost update, allow utilities to amortize prudent PPA capacity expenditures, plus AFPPA for capacity portion of PPA, over life of PPA.

- Allow utilities to earn return on amortization of capacity portion of PPA at utility's allowed ROR, calculated on a pre-tax basis.

- PPAs are subject to a prudence review before amortization of capitalized capacity payments in rates.

- Allow utilities to propose additional utility-specific PBR mechanisms for PPAs using policy goals for incentive mechanisms from UM 409. This could incorporate other proposals developed in this docket.

Benefits: The CIM/pp benefits customers by encouraging utilities to more aggressively acquire cost-effective PPAs. Utility acquisition of new PPAs contributes to the development and maintenance of a robust competitive wholesale market, which ultimately provides customers greater resource optionality.

The CIM/pp is limited in scope in that it only applies to: (1) new PPAs; (2) PPAs of one year or more in duration; and (3) the capacity portion of PPAs, which is capped to prevent cost-shifting to capacity in PPAs. These limitations moderate the rate impact of the CIM/pp. At the same time, CIM/pp should be effective in reducing future imputed debt and associated costs because S&P imputes debt only on the capacity portion of PPAs. From a qualitative standpoint, the CIM/pp should also help enhance the credit quality of Oregon utilities and lower overall costs of capital for new utility investment.

Under the CIM/pp, PPA costs will not be reflected in rates until a prudence review is conducted. Thus, the CIM/pp maintains the regulatory discipline of the risk of a prudence disallowance.

This approach uses a tried and tested framework to incent Oregon utilities to invest in alternatives to rate base generation resources. The CIM/pp is straightforward, easily implemented for all utilities, and allows for utility-specific tailoring of incentives beyond those designed to treat PPAs and rate base generation comparably for regulatory purposes.