

PUBLIC UTILITY COMMISSION OF OREGON
REDACTED STAFF REPORT
PUBLIC MEETING DATE: October 25, 2016

REGULAR CONSENT EFFECTIVE DATE _____

DATE: October 17, 2016

TO: Public Utility Commission

FROM: Lance Kaufman 

THROUGH: Jason Eisdorfer and Marc Hellman 

SUBJECT: PORTLAND GENERAL ELECTRIC: (Docket No. UI 376) Application for Affiliated Interest Transactions related to Gas Reserves.

STAFF RECOMMENDATION:

The Affiliated Interest contract, guarantee of indebtedness and waiver of the lower of cost or market rule are necessary components of Portland General Electric Company (PGE)'s investing in gas reserve costs at issue in Docket No. UE 308. If the Commission allows gas reserve costs into rates in Docket No. UE 308, the Commission should also find that the Affiliated Interest contract is fair, reasonable, and in the public interest; approve the guarantee of indebtedness; and waive the lower of cost or market rule. The Commission should also adopt Staff's proposed deferral treatment and the reporting requirements identified by Staff in this memo.

Should the Commission decline to allow gas reserve costs into rates in Docket No. UE 308, the Commission should find the Affiliated Interest contract is not in the public interest, disapprove the guarantee of indebtedness, and not waive the lower of cost or market rule.

Due to the 90-day statutory period for review of the Affiliated Interest Agreement in this docket discussed below, which expires on November 3, 2016, the Commission should make a decision regarding this docket concurrently with the decision in Docket No. UE 308. The procedural schedule in Docket No. UE 308 contemplates Commission order in this case by November 4, 2017.

DISCUSSION:

Issue

Whether to approve PGE's Affiliated Interest contract, guarantee of indebtedness, and request for waiver of OAR 860-027-0048.

Applicable Law

PGE filed this application with the Commission on August 5, 2016, pursuant to OAR 860-027-0040, OAR 860-027-0041, ORS 757.015 and ORS 757.495. Staff also finds that OAR 860-001-000, OAR 860-027-0035, OAR 860-027-0048, and OAR 860-027-0100 are relevant to this application.

- I. OAR 860-027-0040 addresses filing requirements for applications for approval of transactions between Affiliated Interests.
- II. OAR 860-027-0041 identifies information required for utility goods or services provided to Affiliated Interests.
- III. ORS 757.015 defines Affiliated Interests.
- IV. ORS 757.495 addresses Utility and Commission treatment of Affiliated Interest Contracts.
- V. OAR 860-027-0000(2) provides the Commission authority to waive any rule in Division 27 for good cause shown.
- VI. OAR 860-027-0035 addresses filing requirements for applications by a utility for authority to guarantee indebtedness.
- VII. OAR 860-027-0048 requires that a utility's costs to purchase goods or services from an Affiliated Interest must be recorded in the utility's books at the lower of cost or market.
- VIII. OAR 860-027-0100 requires annual reporting of Affiliated Interest transactions.

This filing consists of three parts, an Affiliated Interest contract, a guarantee of indebtedness by PGE of the Affiliate's debt, and a waiver of the lower of cost or market provision in OAR 860-027-0048(4)(e). ORS 757.495(3) requires that the Commission investigate the Affiliated Interest contract and determine if the contract is fair and reasonable and not contrary to the public interest. ORS 757.495(5) requires that the

Commission indicate approval or disapproval of the guarantee of indebtedness. OAR 860-027-0000(2) allows the Commission to waive OAR 860-027-0048(4)(e) for good cause.

Discussion and Analysis

In this filing Portland General Electric is applying for Commission approval of Affiliated Interest transactions with Portland General Gas Supply Company (PGGS). The transactions facilitate the PGE proposal at issue in PGE's Automatic Update Tariff (AUT) proceeding to recover costs of a capital investment in gas reserves through a cost-of-service purchase gas agreement with its affiliate. PGE has timed this filing to allow the Commission's findings to be concurrent with those in PGE's AUT proceeding, Docket No. UE 308. PGE has provided testimony on and included costs related to PGGS in Docket UE 308. Staff, Citizens' Utility Board of Oregon, and Industrial Customers of Northwest Utilities have provided testimony regarding the PGE/PGGS transactions in Docket UE 308. The Commission held a Hearing on September 21, 2016. The Commission questioned witnesses at that Hearing.

Docket UE 308 is a contested case, contains testimony from PGE's major stake holders, and has a more thorough record regarding the gas reserve investment relative to this Docket. The Commission should rely on the record developed in Docket No. UE 308 when making findings regarding the fairness, reasonableness, and public interest of PGE's proposed cost-of-service gas production investment.

The final order for UE 308 is scheduled for November 4, 2016. The statutory deadline for the Commission to make findings regarding this docket is November 3, 2016.¹ The timing of these dockets allows the Commission's findings in this Docket to be concurrent and consistent with the Commission's findings in Docket No. UE 308. If the Commission decision in UE 308 does not allow costs related to the gas reserve investment into rates, a consistent decision in this docket would be to find the Affiliated Interest contract is not in the public interest, to disapprove the guarantee of indebtedness, and to not waive the lower of cost or market rule.

Should the Commission rule in favor of the Company in UE 308, a consistent ruling in this docket would be to find the Affiliated Interest contract is in the public interest, to approve the guarantee of indebtedness, and to waive the lower of cost or market rule.

The record in Docket No. UE 308 does not include Staff's analysis or recommendations specific to PGE's Affiliated Interest contract, reporting requirements, or waiver of OAR 860-027-0048(4)(e). In this memo, Staff provides specific recommendations if the

¹ ORS 757.495 provides the Commission with 90 days from the filing date to make findings regarding Affiliated Interest contracts.

Commission chooses to include the proposed gas reserve investments into rates in Docket No. UE 308.

Fairness of Contract

In Docket No. UE 308, Staff found PGE's proposal to be unfair due to intergenerational subsidization, whereby current customers subsidize future customers. PGE's argument in favor of the gas reserve investment is that it will reduce long term gas risk. Staff argues that alternate and preferable financial instruments are available to reduce gas risk up to 10 years.

Staff proposes deferred accounting treatment of the portion of the cost of service gas that is above the forecasted cost of gas. Such treatment would defer the portion of the cost of service gas costs that are above the initially forecasted gas price. This treatment consistently aligns the costs of the investment with the primary time period of the incremental benefit of the gas reserve investment over a traditional financial hedge. If the Commission supports Staff's proposed deferral treatment, the Commission should direct Staff, PGE, and any interested party to collaborate in developing a proposal for later ratemaking treatment of the deferred amounts that aligns the costs and benefits of the gas reserve investment without harming PGGS or PGE.

Public Interest of Contract

In Docket No. UE 308 Staff found PGE's proposal to be speculative and not likely to increase rate stability. Staff also found that alternate gas hedging mechanisms would provide customers with greater rate stability without exposing customers to additional risk. For these reasons Staff found that the proposal presented in Docket No. UE 308 is not in the public interest.

The proposal in this docket is directly related to the proposal in Docket UE 308. If the Commission rules in favor of the Company in Docket UE 308, than the Commission is implicitly ruling that the Affiliated Interest contract is in the public interest. This is because the Affiliated Interest contract is an integral part of the gas reserve investment, and the investment will not be undertaken without approval of the Affiliated Interest contract.

Affiliate Reporting Requirements

PGE's proposed gas reserve investment is a new and uncommon electric utility investment. Due to the controversial nature of the investment, and PGE's intention **[Begin Confidential]** [REDACTED], **[End Confidential]** the Company should present operational reports that contain more detail than the general Affiliated Interest report. Staff recommends the annual reports contain the following information.

- A. Side by side comparison of actual values, initial (investment decision perspective) forecast, and AUT forecast of production volumes and cost-of-service gas prices.

- B. Actual and last three years side-by-side comparison of:
 - i. Production volume
 - ii. Cost of service gas price
 - iii. Summary of production costs on a total and per unit basis
 - iv. Sale prices and quantities for marketed gas and liquids
 - v. Detailed trial balance
 - vi. Income statement

- C. Current year only reporting of:
 - i. Hedge comparison report matching cost of gas from PGGs to market indicators (spot, near futures, swaps).
 - ii. General ledger as a work paper
 - iii. Risk report (Spills, fines and citations, new regulations, etc.)

The annual reporting will be satisfied with two separate reports. PGE will provide PGGs production, cost, sales, and market detail with PGE's AUT filing by April 1. PGE will provide PGGs financial detail with PGE's Affiliated Interest Report by June 1.

PGE has proposed a five-year review of the gas reserves drilling program. After five years, PGE will provide a reassessment report as part of a docketed proceeding in order to allow other parties the opportunity to comment. The report will evaluate how PGGs's hedging results have been trending. As noted in UE 308 PGE Exhibit 200, PGE would expect, after the initial five-year period, a Commission decision regarding ratemaking treatment of the gas reserve investment that would indicate one of the following:

- Reauthorize PGE's long-term gas hedging as currently operating;
- Reauthorize PGE's long-term gas hedging program but with modifications to the program or additional conditions/guidelines; or
- Decline to authorize any additional long-term gas hedging agreements or transactions while continuing to permit recognition in rates natural gas acquired under prior transactions.

Guarantee of Indebtedness

PGE currently has sufficient liquidity to satisfy the proposed guarantee of indebtedness.

[Begin Confidential] [REDACTED]

[Redacted]

Confidential]

[End

For these reasons Staff finds the guarantee to be reasonable. Should the Commission find in favor of the gas reserve investment, the Commission should approve the guarantee of indebtedness.

Waiver of Lower of Cost or Market Rule

OAR 860-027-0000(2) provides the Commission authority to waive Division 27 rules for good cause shown. If the Commission approves cost-recovery of the gas reserve investment in Docket No UE 308, Staff recommends that the Commission approve PGE's request to waive the requirement that PGE record its costs associated with the PGGGS contract at the lower of cost or market. According to the Company, **[Begin Confidential]** [Redacted] **[End Confidential]** and PGE's Power Cost Adjustment help protect customers from significant cost changes due to deviations in production. As such, a waiver of the lower-of-cost-or-market rule is necessary for cost of service gas prices.

Conclusion

Staff makes the following recommendations to the Commission:

The Commission should make a decision regarding this docket concurrently with the decision in Docket No. UE 308. Should the Commission allow gas reserve costs into rates in Docket No. UE 308, the Commission should also find that the Affiliated Interest contract is in fair, reasonable, and in the public interest; approve the guarantee of indebtedness; and waive the lower of cost or market rule. The Commission should also adopt Staff's proposed deferral treatment and the reporting requirements identified by Staff in this memo.

Should the Commission decline to allow gas reserve costs into rates in Docket No. UE 308, the Commission should find the Affiliated Interest contract is not in the public interest, disapprove the guarantee of indebtedness, and not waive the lower of cost or market rule.

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PROPOSED COMMISSION MOTION:

Make findings in this Docket concurrently with Docket No. UE 308 and adopt Staff's recommendations in the Staff Memo for this docket.

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