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May 19, 2006

Via Electronic Filing and U.S. Mail

Oregon Public Utility Commission
Attention: Filing Center
PO Box 2148
Salem OR 97308-2148

Re: In the Matter of the Adoption of Permanent Rules to Implement SB 408, Relating to Matching Utility Taxes Paid with Taxes Collected
OPUC Docket No. AR 499
Reply Comments on Straw Proposals of PGE

Attention Filing Center:

Enclosed for filing in the above-captioned docket is Portland General Electric's Reply Comments on Straw Proposals. 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,

Inara K. Scott

cc: AR 499 Service List

Enclosure

BEFORE THE PUBLIC UTILITY COMMISSION

OF OREGON

AR 499

In the Matter of the Adoption of Permanent Rules Implementing SB 408 Relating to Utility Taxes	REPLY COMMENTS OF PORTLAND GENERAL ELECTRIC ON STRAW PROPOSALS

I. INTRODUCTION

Senate Bill 408 (SB 408) brings significant change to Oregon's regulatory framework. The task for this docket and related proceedings is to develop rules and practices for implementing this change that result in "safe and adequate service at fair and reasonable rates" (per ORS 756.040) and, ultimately, produce rates under the required automatic adjustments clauses that are "fair, just and reasonable" (per the SB 408 amendments to ORS 757.210).

Although some portions of SB 408 are clear, with unambiguous definitions, others are not. The straw proposals presently before the Public Utility Commission of Oregon (Commission) concern the term "properly attributed" and the workings of the automatic adjustment clause that SB 408 requires to "account for all taxes paid . . . and all taxes that are authorized to be collected through rates, so that ratepayers are not charged for more tax than [] the utility pays. . ." Section 3(6). Portland General Electric Company (PGE) prepared three straw proposals directed toward the workings of the automatic adjustment clause. We prepared these straw proposals to enable the Commission to answer in the positive the question whether, at the conclusion of this docket, the rules and practices developed to implement SB 408 will meet all applicable legal requirements while still assuring safe and adequate service at fair, just and reasonable rates.

Comments opposing PGE's straw proposals offer two primary lines of argument:

1. SB 408 "unambiguously" requires that the Commission calculate rate adjustments based on numerical revenue requirement assumptions from a previous rate case that are almost certainly different from the revenues and expenses the utility actually faced during the tax year in question. Staff's Comments on Straw Proposals at 7-8, AR 499 (May 3, 2006) (Staff Comments); Opening Comments of ICNU/NWIGU on the Properly Attributed and Taxes Collected/Earnings Test Straw Proposals at 16-17, AR 499 (May 3, 2006) (ICNU/NWIGU Comments).
2. SB 408 does not discuss the use of earnings tests or deferred accounting and, therefore, including such tools in its implementation is not appropriate. Staff Comments at 5-6; ICNU/NWIGU Comments at 17-20; Comments of the City of Portland re Straw Proposals at 2, AR 499 (May 3, 2006) (City of Portland Comments).

PGE disagrees with both lines of argument. The straw proposal that we prepared for determining the rate under the automatic adjustment clause is within the Commission's discretion. The Attorney General's Opinion of December 27, 2005 (Attorney General's Opinion) does not require otherwise. The other straw proposals that we prepared, including the use of an earnings test in the automatic adjustment clause and accompanying the workings of that clause with selective use of deferred accounting, are also well within the Commission's discretion and duty under ORS 756.040 and 757.210.

II. Calculating Rates Under the Section 3(6) Automatic Adjustment Clause

A. PGE's Proposal Helps Prevent Unreasonable Outcomes

At the outset, PGE believes it important to state clearly for the Commission which outcomes of the automatic adjustment clause we have designed our proposal to prevent, and which outcomes parties opposing our proposal would allow to occur:

1. **When, in the course of fulfilling its obligation to serve, a utility incurs fewer expenses than the Commission assumed it would incur in the last rate case, the automatic adjustment clause under SB 408 will surcharge customers and increase the utility's earnings on these utility services.**

2. **When, in the course of fulfilling its obligation to serve, a utility incurs more expenses than the Commission assumed it would incur in the last rate case, the automatic adjustment clause under SB 408 will require the utility to make a refund to customers and decrease the utility's earnings on these utility services.**

None of the comments opposing PGE's proposals mention the first effect that adoption of our proposals will prevent, and the parties to AR 499 agreed early on that the automatic adjustment clause could result either in surcharges or refunds to customers. PGE has found little evidence to suggest, however, that either Legislators or our customers want PGE to assess additional surcharges for years in which the utility already has earned more than its authorized rate of return, nor does PGE want to assess surcharges under these conditions. Such a surcharge would not result in the "fair" rates ORS 756.040 requires.

The opponents of our proposals acknowledge that the second result may occur, but excuse it by claiming that any increase in actual expenses over the amount assumed in rates reflects imprudence, failure to control costs, or a similar cause that justifies penalizing the utility and shifting the tax effects of these expense changes to customers, even though the burden of the actual expense remains with the utility. City of Portland Comments at 2-3; Straw Proposals of ICNU/NWIGU: Properly Attributed (Revised) and Taxes Collected/Earnings Test at 6-8; ICNU/NWIGU Comments at 16-17. In fact, the vast majority of increased costs will relate to

prudent and necessary utility expenditures.[1] Moreover, the regulatory framework already has adequate disincentives for imprudence or failure to control costs.

SB 408 was not a "cost-control" bill, and to suggest now that this cost-control rationale justifies the unintended and unfair results of the bill misrepresents the Legislature's goal in enacting it.

B. Comprehensive Cost "Pass Through" Also Largely Prevents Unreasonable Outcomes under 3(6)

The ICNU/NWIGU comments propose to exempt from the effects articulated above (refunds or surcharges related to cost variances) one category of costs: the purchased gas costs incurred by a natural gas distribution utility. ICNU/NWIGU Comments at 17. This is a significant departure from the position otherwise advocated in the comments, yet the explanation offered to support distinguishing these purchased gas costs could fit any electric or gas utility expense. The ICNU/NWIGU Comments state, "These amounts are known when the amount of "taxes collected" is determined and are passed through to customers without affecting the utility's profits." *Id.* In fact, all actual utility expenses are known when the amount of "taxes collected" is determined. Moreover, the "pass through" of any cost will have the same effect on the utility's profit: the difference between what the Commission assumed that cost would be when it set rates and what the cost actually is will neither increase or decrease the utility's profits in that year.[2]

The Commission's current regulatory framework "passes through" some costs and not others, some through tariffs and others through deferrals. The Commission could substantially

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[1] In Section III, we address those costs that were never included in rates, such as disallowed costs or investments between rate cases.

[2] A cost that the Commission does not "pass through" does affect utility profits to the extent that the actual cost is less than or more than the amount assumed in the rate setting process.

mitigate the outcomes described at the beginning of this section by passing through a greater percentage of the utility's costs. PGE provided examples in its Opening Comments on Straw Proposals that illustrate this point. *See* Comments of PGE on Straw Proposals at Exhibit A, AR 499 (May 3, 2006). In Example 2, PGE demonstrated the effect of an SB 408 adjustment on a utility with a robust PCA. *Id.* at Exhibit A, page 2. In the event of increases or decreases in power costs, the PCA moved the utility closer to its authorized return on equity (ROE), while the SB 408 adjustment moved the utility further from its authorized ROE. However, in Example 2, the adjustment resulted in an adjustment of approximately 20 basis points. In Example 3, where the utility has no PCA, the SB 408 adjustment moved the utility almost 100 basis points away from its authorized ROE. *Id.* at Exhibit A, page 2.

Nothing about SB 408 changes the Commission's ability to set its policies regarding which costs it passes through and thus precludes from "affecting" profits. If Staff and parties indicated support for more comprehensive pass-through of utility power costs to treat them in a manner similar to purchased gas costs, PGE's concerns about the implementation of SB 408 3(6) would be greatly diminished.

C. The Attorney General's Opinion Does Not Bar PGE's Straw Proposal

Comments by Staff and ICNU/NWIGU suggest that the Attorney General's Opinion rejected PGE's proposal for making the calculations required for the automatic adjustment clause under section 3(6). This is simply not the case. In a scant two pages, the Attorney General's Opinion addresses the definition of "taxes authorized to be collected in rates" which, it states, "is used once in chapter 845: paragraph 3(1)(b)." Attorney General's Opinion at 27 (discussing preparation of utility tax report). The Attorney General's Opinion did not express any opinion on the calculations necessary to implement section 3(6)'s automatic adjustment clause.

Not only does the Attorney General's Opinion not discuss the appropriate interpretation of the terms found in 3(6), it does not identify the precise values that must be used in the computation of 3(13)(e)(B) and (C) for purposes of the tax report. The Attorney General's Opinion, in fact, rejects the notion that the language of the bill requires that those values be derived from "test year data." *Id.* Rather, the Attorney General determined that the values must be values "determined" and "used" by the Commission "in previously establishing rates for the utility," which the Attorney General concludes requires that the values be derived from "prior actions by the Commission." However, the Opinion does not state that utilities must rely solely on data included in a general rate case. Instead, the Opinion states: "[t]o the extent that the information necessary to derive these values appears in the test period data approved by the Commission in establishing rates for a specific utility, then the utility should use that information." (emphasis added).

In preparing the Results of Operations report which PGE and other utilities regularly file with the Commission, PGE routinely uses information from its last general rate case. This information tells PGE what adjustments to make to the actual revenues and expenses it has experienced during that year to state the results on a "regulated" basis, including removing expenditures for particular items found not recognizable for ratemaking purposes (for example, certain incentive compensation program costs). It is a stretch to say that the Opinion requires that utilities use the exact numbers from a prior rate case in preparing their tax reports.

PGE offered its straw proposal for implementing the automatic adjustment clause on the belief that the Commission has the ability to exercise its discretion and judgment to set rates under the automatic adjustment clause in a fair, just and reasonable way, and can order utilities to use the same rate case information they presently use to report earnings to make the calculations necessary for the automatic adjustment clause. We do not believe that our suggestion is

"remarkable." Staff Comments at 7. We believe that it is consistent with the Commission's obligations under all of the statutes that guide its delegation of authority from the Legislature and with sound public policy.

III. Earnings Test

The Comments of ICNU/NWIGU and Staff state that nothing in SB 408 requires the use of an earnings test. ICNU/NWIGU Comments at 20; Staff Comments at 6. Nothing about SB 408, however, suspends the Commission's statutory duty to ensure fair and reasonable rates to consumers and utilities under ORS 756.040. Moreover, ORS 756.062 specifically requires that the Commission "liberally" construe the provisions of laws applicable to it to "promote the public welfare, efficient facilities and substantial justice between customers and public . . . utilities." The Legislature did not need to repeat these requirements in SB 408 – the requirements already existed in the statutes. If including an earnings test in the 3(6) automatic adjustment clause results in outcomes that are fairer and more reasonable for both consumers and utilities, the Commission is fully empowered and, indeed, obligated to do so.

The Comments of ICNU/NWIGU argue against including an earnings test in the 3(6) automatic adjustment clause on several grounds. First, the Comments assert that an earnings test would provide the utilities a financial buffer from the effect of cost increases in other areas. ICNU/NWIGU Comments at 19. This is not the case. The earnings test would mean only that, if the difference between taxes paid and taxes found collected in rates (or "taxes charged") was the result of cost increases (as opposed to revenue changes), the utility would not make a tax refund to customers on top of the expense increase it bore. Conversely, the earnings test would mean that, if the difference between taxes paid and taxes found collected in rates (or "taxes charged") was the result of cost decreases, the utility would not collect additional taxes from customers for savings customers did not receive.

Second, the Comments claim that including an earnings test would turn the automatic adjustment clause process into a mini-rate case. *Id.* at 20. The automatic adjustment clause will change rates and, thus, is a rate case already. How much process it requires will depend on procedures adopted in the instant docket and on whether the outcome is fair and reasonable. As we have noted previously, the Commission may not set a rate that is not fair, just and reasonable. ORS 757.210. Just as clearly, the Commission could not deny utilities due process consideration of rate adjustments under SB 408 Section 3(6). An earnings test would increase the likelihood of a fair outcome from the initial rate setting process; it would not add unnecessary procedure to that process.

Last, the Comments claim that the earnings test will eliminate the incentives to control costs. ICNU/NWIGU Comments at 20. This is wrong. Utilities' incentives to control costs—which are necessarily limited to those costs the utility can control—will not change. If costs rise between rate cases, the utility and its shareholders pay the entirety of those costs. The earnings test simply means that where the utility is not earning its authorized return on equity, it need not then incur an additional expense equal to the tax effect of these cost changes, by refunding to customers taxes allegedly collected during the period in which the utility experienced the increased cost.

Overall, the regulatory framework should serve the broad purposes of the state. A component of the framework should serve the subsidiary purpose set for that component, while not contradicting those broad purposes. The goal of SB 408 was to neutralize the impact of taxes on a company's return to its investors, so that neither utilities nor their investors would profit from the inclusion of taxes in rates. The earnings test meets this goal by ensuring that adjustments do not take place above or below the authorized ROE.

IV. Deferral

The Comments of ICNU/NWIGU and the City of Portland argue that the Commission should not allow utilities to recover costs related to disallowed expenses through the operation of SB 408. City of Portland Comments at 2-3; ICNU/NWIGU Comments at 17-18. This argument is illogical. SB 408 would refund to customers a tax benefit associated with a disallowed cost or an expense that was never in rates, while the utility and its shareholders pay the entirety of the actual expense, a plainly unfair result. If customers will receive a benefit from the disallowance or new investment, they must pay some portion of the cost associated with it. This is what the deferral mechanism allows the Commission to do: neutralize the impact of SB 408 by crediting the utility for the amount of the tax benefit that is conferred upon customers.

The ICNU/NWIGU Comments state that the deferral statute does not allow this type of use. ICNU/NWIGU Comments at 18. In fact, PGE noted in its Opening Comments, one of the stated purposes of ORS 757.259 is to match benefits and burdens. Staff specifically called out this principle in its Comments, describing this "fundamental principle" as stating "ratepayers should bear only costs for which they are responsible….[I]f they do not bear the costs, they should not get the related tax benefit." Staff Comments at 2. This is precisely the purpose to which PGE would apply the deferral: to correct an imbalance where ratepayers are attributed tax benefits for which they bore no costs.

ICNU/NWIGU's Comments go on to claim that deferrals are limited to situations in which "a particular type of event has a requisite financial impact on the utility" and that "the financial impact on a utility of a disallowed costs would not fit either of these criteria." ICNU/NWIGU's Comments at 18, citing Docket UM 1147, Order 05-1070 (Oct. 5, 2005). In fact, that order states that it simply considers "the magnitude of the financial impact of the event." Order 05-1070 at 3. The financial impact of an adjustment under SB 408 that attributes

to customers tax benefits associated with non-utility costs or disallowed costs, could easily occur at the magnitude contemplated by the statute.

Finally, ICNU/NWIGU's Comments argue that the Commission should not authorize rules that would "call for reauthorization of a deferred account 'each year'." ICNU/NWIGU Comments at 18. This argument misinterprets PGE's proposal. Though a deferral may be needed each year, PGE did not envision the Commission creating a blanket rule that would authorize a deferral each year for every utility. Rather, PGE anticipated that each utility would have to operate under existing ORS 757.259 guidelines and prove what benefits and burdens they sought to match through a deferral application.

This proposal does not require specific rule language to be adopted in AR 499. PGE offered this suggestion as a straw proposal in order to highlight one means of addressing an otherwise unjust and unfair result of SB 408. PGE also offered this as a straw proposal because we anticipated other parties would object to the use of a deferral mechanism on the grounds that it was not authorized by SB 408. In order to address these objections, the Commission may wish to adopt a general rule noting that deferrals authorized under ORS 757.259 do not conflict with SB 408, if necessary to ensure rate adjustments under Section 3(6) do not inappropriately misalign the costs borne by and benefits received by ratepayers.

V. CONCLUSION

PGE offered three straw proposals that: 1) address the impacts of SB 408 on stand-alone utilities; 2) interpret otherwise ambiguous language in the law; and 3) provide substance and detail around the Commission's duty to set fair, just and reasonable rates. As presently interpreted by many parties to AR 499, SB 408 will have significant unintended consequences on utilities, with serious financial implications, that were neither anticipated or desired by Legislators. PGE's proposals will address these consequences and ensure that the Commission's

duties under ORS Chapter 757 and 756 are met. These proposals do not contradict the Attorney General's Opinion. They are consistent with existing state law and exemplify good regulatory policy. They are well within the authority of the Commission, and are necessary to ensure that SB 408 is implemented in a just and equitable fashion.

DATED this 19th day of May, 2006.

Respectfully submitted,

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CERTIFICATE OF SERVICE

I hereby certify that I have this day caused the foregoing REPLY COMMENTS OF PORTLAND GENERAL ELECTRIC COMPANY ON STRAW PROPOSALS to be served by First Class US Mail, postage prepaid and properly addressed, and by electronic mail, upon each party on the attached service list.

Dated at Portland, Oregon, this 19th day of May, 2006.

/s/ INARA K. SCOTT
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AR 499
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