Portland General Electric Company
Legal Department
121 SW Salmon Street • Portland, Oregon 97204
(503) 464-8926 • Facsimile (503) 464-2200

Douglas C. Tingey
Assistant General Counsel

September 14, 2011

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: UE 228

Attention Filing Center:

Enclosed for filing in the captioned docket are an original and five copies of:

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

This is being filed by electronic mail with the Filing Center. An extra copy of the cover letter is enclosed. Please date stamp the extra copy and return to me in the envelope provided.

Thank you in advance for your assistance.

Sincerely,

DOUGLAS C. TINGEY
Assistant General Counsel

DCT:cbm
Enclosures
cc: UE 228 Service List

BEFORE THE PUBLIC UTILITY COMMISSION OF OREGON

UE 228

In the Matter of	)
	)
PORTLAND GENERAL ELECTRIC COMPANY	)
	)
2012 Annual Power Cost Update Tariff (Schedule 125)	)
	)

OPENING BRIEF OF PORTLAND GENERAL ELECTRIC COMPANY

September 14, 2011

I. Introduction

This Annual Power Cost Update ("AUT") docket is about PGE's hedging policy and practices, in particular its Mid-Term Strategy. All other issues have been resolved.

CUB and ICNU ask the Commission to adopt a new hedging policy for PGE that is unsupported by the evidence. They also ask the Commission to impose that unsupported hedging policy retroactively to 2007, and then levy a disallowance on PGE for not complying with this new hedging policy.

PGE disagrees categorically. PGE's Mid-Term Strategy has been clearly and openly communicated to the Commission and the parties since before its adoption in 2006, and many times since. PGE's Mid-Term Strategy was designed to meet PGE's customers' desire and need to reduce price volatility and it achieved its goal. PGE executed this strategy prudently and consistent with industry practice, and it appropriately balanced cost and risk throughout the program's execution.

Despite this, CUB and ICNU have argued for significant adjustments to PGE's Net Variable Power Costs (NVPC) related to gas hedging contracts entered into beginning in 2007 as part of PGE's Mid-Term Strategy. Many of these contracts have been included in rates in previous AUT proceedings. PGE entered into these contracts on behalf of customers and will incur the costs of these contracts in 2012, but CUB and ICNU argue that the costs should not be recovered in rates.

Commission Staff has reviewed PGE's filing, supporting work papers, documents provided as Minimum Filing Requirements under Schedule 125, and discovery in this proceeding. Staff recommends no adjustment to 2012 NVPC as filed.

As demonstrated below, PGE's Mid-Term Strategy was well-designed, well-executed and it successfully reduced customer price volatility. The proposed adjustments are improper, unsupported, and opportunistic. It would not be fair, just or reasonable for the Commission to now adopt a different hedging policy for PGE and apply it retroactively to 2007. PGE's 2012 power costs should be approved, resulting in a projected small decrease in overall rates for customers.

II. The record establishes that customers sought price stability and PGE's Mid-Term Strategy was successful in achieving it.

A. PGE designed the Mid-Term Strategy to meet customer needs.

PGE is an energy short utility and has been for over 15 years. Because it is a short utility, PGE is very dissimilar to other utilities in the region, and PGE's customers are more exposed to changes in the market price of power than customers of most other utilities.

Customers have told PGE that they value less volatile and more stable retail prices, as confirmed in a survey fielded in preparation for the 2007 Integrated Resource Planning docket (LC 43). PGE's industrial customers in particular indicated that they preferred more predictable price increases rather than the lowest average price. PGE/300/Pope-Valach/6 at lines 4-16; PGE/301/Pope-Valach (customer survey); PGE/400/Lobdell-Outama/6 at line 17 – 7 at line 3; *see also* PGE/500/Stoddard/5 (discussing customers' needs for long-term stable rates). With that goal in mind, PGE compared its then current planning and hedging strategies with customers' stated desires.

Prior to the introduction of the Mid-Term Strategy, PGE was hedging its gas and power exposure up to two years in advance. At the same time, the Commission's IRP process dealt with acquisitions, and generating assets, beyond five years in the future.

These strategies left a gap in the two- to five-year period that was not then being actively managed, resulting in significant volatility in power prices.

In 2006, PGE designed the Mid-Term Strategy to close the gap between long-term power planning and short-term purchasing, with the goal of reducing the volatility of PGE's power prices by hedging the price risk up to five years out. PGE/400/Lobdell-Outama/7-9. The Mid-Term Strategy starts with an examination of PGE's total Net Open Position ("NOP") for the five-year span. This Net Open Position is the cumulative open position of both power and gas. PGE/400/Lobdell-Outama/11-12. By 2007, the market for gas in particular had become more robust and liquid for certain calendar products for delivery out at least five years. This development made implementation of the Mid-Term Strategy cost-effective.

Customers' price volatility is a function of two main drivers: volatility in the commodities markets and the size of PGE's portfolio NOP. The fundamentals (including price and market liquidity) of power and gas markets are beyond PGE's control. What PGE can financially "control" or hedge is the size of PGE's NOP and, by doing so, it can successfully reduce the volatility of customers' rates. PGE hedges its NOP partially through the Mid-Term Strategy.

B. ICNU and Mr. Schoenbeck fail to address the total risk faced by PGE and its customers.

Throughout this proceeding, Mr. Schoenbeck's analysis has only examined PGE's open position for gas. Although in his reply testimony (ICNU/100/Schoenbeck/4-5), Mr. Schoenbeck states that the "critical elements" of a successful hedging strategy include the "diversification principle of portfolio theory," his analysis completely ignores the overall risk of PGE's portfolio; the risk that PGE must manage for its customers is the total open position of both gas and power. Nowhere in his testimony does Mr. Schoenbeck correctly identify the risk that PGE must manage. This "gas only" perspective is a fundamental flaw in Mr. Schoenbeck's approach, and shows a lack of understanding of how to design and implement a hedging strategy.

By contrast, Mr. Stoddard examined the total energy position of PGE and concluded that PGE's use of gas to close its net open energy position was reasonable and common industry practice. PGE/500/Stoddard/14-15. He further noted that at no time did PGE buy more gas than its generation portfolio required on an annual average basis, nor did it hedge more energy than it needed in any quarter. Hearing Transcript/ Stoddard/69 at line 18 – 70 at line 21.

C. PGE's Mid-Term Strategy addressed PGE's total net open position in a comprehensive, well-documented policy.

The Mid-Term Strategy, which is part of PGE's overall risk management strategy, was developed after careful analysis of the risks facing customers and of the ability of a hedging strategy to lessen those risks. PGE also developed tools to mitigate its risks when implementing the Mid-Term Strategy under its Energy Risk Management Policies and Procedures ("ERMP&P"), which are contained in PGE Exhibit 601 in this docket.

PGE's Mid-Term Strategy, which is executed under the umbrella of its ERMP&P, is sound and effective. Based on a comprehensive risk analysis, PGE establishes annual purchasing targets to reduce its open position. PGE/400/Lobdell-Outama/17-18. To meet these targets, PGE traders first determine if there is sufficient liquidity in the gas and power markets for products with delivery as far as five years out. Liquidity is often determined by assessing the availability of a product, the tightness of the bid-offer spread of that product and the depth of the market for that product; if the spread is tight and there is adequate depth in the market, then the product is deemed to be liquid. If the spread is wide, then it is likely that a significant premium must be paid for the product and the market is deemed to be less liquid. Hearing Transcript/Outama/31 at line 22 – 32 at line 16. If sufficient liquidity is present for trades consistent with the targets, the traders then seek approval from management to enter into a trade as required by PGE's ERMP&P.

The approval memos for the subject trades have been admitted as ICNU Exhibit 110, pages 37-141. The memos show that, if pre-approval is granted, such approval is subject to:

- A specific time limit within which the trade must be executed,
- An approved price range that must be met, and
- A defined length, or tenor, for the transaction.

Finally, the Risk Management Committee, chaired by PGE's Chief Executive Officer, provides oversight of the requirements for transaction approval. PGE/400/ Lobdell-Outama/17-18. The Risk Management Committee also reviews and approves, as necessary, any changes in the parameters of the Mid-Term Strategy annually for the upcoming year. *Id.* Thus there are several layers of policies in place that guide the Mid-Term Strategy. The Mid-Term Strategy is a thoughtfully executed and carefully supervised hedging strategy. PGE/500/Stoddard/29-30.

D. PGE's Mid-Term Strategy achieved price stability.

The goal of PGE's Mid-Term Strategy was, and is, to reduce the volatility of PGE's customers' retail rates by reducing PGE's net open position for gas and power over a rolling five-year period. PGE/400/Lobdell-Outama/7 at lines 10-12. Despite agreeing that a major goal of any hedging strategy is to reduce price volatility

(ICNU/109/Schoenbeck Deposition/38 at lines 23-25), Mr. Schoenbeck admits that he never actually analyzed whether PGE's hedging strategy did in fact reduce the volatility in PGE's net variable power costs. ICNU/109/Schoenbeck Deposition/93 at lines 21 – 24. However, Mr. Schoenbeck confessed that he would "be very surprised if it did not" reduce volatility in power costs. ICNU/109/Schoenbeck Deposition/93 at line 21 – 94 at line 3 (also included as PGE Exhibit 412C).

As shown by PGE's analysis (and never refuted by ICNU or CUB), PGE's Mid-Term Strategy was successful at reducing PGE's net open position for both power and gas. PGE/400/Lobdell-Outama/9, Table showing reduction in PGE's net open position. As a result, PGE's execution of its Mid-Term Strategy reduced volatility year-over-year as shown in Table 1, PGE/400/Lobdell-Outama/19. The success of PGE's Mid-Term Strategy must be judged based on the goal it set out to achieve: reduction in price volatility. Hearing Transcript/Stoddard/77. PGE's execution of the Mid-Term Strategy achieved its goal. *Id.*

III. In contrast to the success of PGE's hedging strategy in achieving its goal of price volatility reduction, Mr. Schoenbeck has not provided any testimony demonstrating how his proposed hedging strategy would better reduce customer price volatility than the strategy employed by PGE. Reduced volatility does not mean lowest price.

As ICNU and CUB admit, a hedging strategy cannot "beat the market." ICNU/100/Schoenbeck/4 at line 11 – 5 at line 2; CUB/100/Jenks-Feighner/4 at lines 4-5. Hedging strategies are not designed to obtain the lowest cost option, but rather to reduce volatility and achieve greater predictability for customer rates. PGE/300/Pope-Valach/8 at lines 3-7; PGE/500/Stoddard/5 at lines 1-5. ICNU further admits that a more stable predictable rate "always comes at a price." ICNU/109/Schoenbeck Deposition/126 at lines 6-8. Indeed, PGE had informed its stakeholders that reducing volatility may come at the expense of not realizing the absolute lowest possible cost. PGE/400/Lobdell-Outama/34 at line 22 – 35 at line 2. Reducing volatility, by definition, means that in a rising wholesale gas and electricity market, retail rates will not go up as fast or as high as they otherwise would, and in a falling wholesale gas and electricity market, customers' rates will not fall as fast or as low as they otherwise would. PGE 500/Stoddard/6 at line 17 –7, line 9. Here, ICNU and CUB admit that hedging cannot "beat the market" and that a stable predictable rate "always comes at a price," yet only now do they complain about PGE's hedging policy when the hedges came at a price that did not "beat the market."

As Mr. Stoddard explained is his testimony, Mr. Schoenbeck's disallowance is not premised on PGE's failure to attain some level of risk reduction. Hearing Transcript/Stoddard/74 at lines 8–21. Nor is the proposed disallowance the difference between PGE's Mid-Term Strategy and Mr. Schoenbeck's proposal. It is instead simply the mark-to-market (dollar) value associated with certain arbitrarily selected transactions. For the portion of the net open position that the selected transactions previously closed, the proposed disallowance therefore represents a no-hedge strategy.

IV. PGE's Mid-Term Strategy was prudent; it was both reasonable and consistent with industry practices.

A. PGE's Mid-Term Strategy must be judged on what was known at the time.

The prudence of PGE's hedging policy must be judged by what was known at the time. An ex post review is not appropriate. PGE/500/Stoddard/9 at lines 1-12. ICNU agrees that prudence must be judged based on information known at the time, and ICNU admits that, even if in retrospect a hedge is "out of the money," that is not indicative of whether it was a prudent hedge at the time the transaction was executed.

ICNU/109/Schoenbeck Deposition/52 at lines 4-20.) Mr. Schoenbeck admits that five years ago long-term gas prices were forecasted to trend upward (ICNU/109/Schoenbeck Deposition/44 at lines 2-20), but nowhere in his testimony does he address the market projection (five years ago) of future price *volatility,* which is a key parameter in determining how much and when to hedge.

Based on the stated desire of customers to reduce retail rate volatility, coupled with the facts known at the time that PGE had a substantial net open position, and the expectation at the time that gas and power market volatility would remain high, PGE prudently reduced its net open position to manage customers' price volatility. Hearing Transcript/Stoddard/75 at lines 1-14, 78 at line 7 – 79 at line 1, 155 at line 21- 156 at line 10.

B. PGE's hedging strategy was consistent with industry practice.

PGE's hedging strategy was consistent with industry practice. PGE/500/ Stoddard/13 at lines 13 – 17; Hearing Transcript/Stoddard/75 at lines 1-14, 78 at line 5 – 79 at line 1, 155 at line 20 – 156 at line 10. Mr. Stoddard, who has extensive, direct experience in utility hedging programs both for utilities and their regulators (PGE/501/Stoddard; Hearing Transcript/Stoddard/61 at lines 12-21), testified that PGE's Mid-Term Strategy was reasonable, well-documented, consistent with industry practice, administered with appropriate oversight, and well-communicated to the Commission and stakeholders. PGE/500/Stoddard/4 at lines 10-16, 6 at lines 8-12. Mr. Stoddard further described PGE's administration of the Mid-Term Strategy as "exemplary." Hearing Transcript/Stoddard/74 at line 22 – 75 at, line 14. Both the products used, and the tenor covered, were within the industry norm.

C. PGE's hedging strategy was appropriately documented, communicated and executed consistent with PGE's policies.

PGE's power supply strategy comprises three periods: (1) near-term, consisting of approximately the next 24 months; (2) mid-term, consisting of years 3 through 5; and (3) long-term, consisting of year 6 and beyond. PGE's Mid-Term Strategy is documented in its presentation to the OPUC, PGE's Risk Management Committee, and PGE's Board of Directors, as well as in its Energy Risk Management Policies & Procedures. PGE/601. These policies were appropriately detailed to provide guidelines while remaining flexible enough to be effectively executed. In addition, these policies were reviewed annually by the Risk Management Committee, which included company executives and those familiar with trading and hedging gas and power. PGE/400/Lobdell-Outama/20-21; Hearing Transcript/Lobdell/57 at lines 8-20. PGE's execution of those policies is documented in its pre-approval memoranda, contained in ICNU/110/Schoenbeck/37-141, and in its trade confirmations.

Moreover, PGE's Risk Management Committee, after receiving the results of a thorough analysis, provides risk limits and oversight to ensure compliance with its policies, guidelines and procedures. PGE/400/Lobdell-Outama/17 -18; Hearing Transcript/Lobdell/57 at lines 8-20. As Vice President James Lobdell testified, he meets daily with the traders to monitor the day-to-day operations, and participates in the meetings of PGE's Risk Management Committee, which oversees PGE's hedging strategy. Hearing Transcript/Lobdell/27 at lines 21 – 28 at line 14; 57 at lines 8- 20; 125 at lines 18-25.

Interestingly, neither ICNU nor CUB identified any transactions that violated PGE's policies. In fact, Mr. Schoenbeck admitted that PGE's hedges were consistent with

PGE's hedging policy. ICNU/Schoenbeck/100/6 at lines 1-6; ICNU/109/Schoenbeck Deposition/97 at lines 13-16. Although ICNU has provided no testimony concerning the documentation of PGE's hedges, at the hearing ICNU used a transcript of the July 27, 2006, Commission public meeting to question PGE witnesses regarding the level of documentation for transactions executed under the Mid-Term Strategy. The portion of the transcript ICNU referred to consisted of comments from Commission Staff member Maury Galbraith. These comments were not requirements of the Commission. Nonetheless, the documentation PGE provided meets the expectations of Staff. The best evidence of this is that Staff has not raised an issue in this docket or any other docket regarding PGE's Mid-Term Strategy, and has never proposed an adjustment to PGE's power costs as a result of transactions made under the Mid-Term Strategy. PGE's Mid-Term Strategy was communicated to the PUC, PUC Staff, and PGE customers, including intervenors. The preapproval process has been described above. The preapproval memoranda themselves are in the record in this proceeding as ICNU Exhibit 110, pages 37-141.

D. The Mid-Term Strategy was transparent.

PGE initially presented its Mid-Term Strategy at the above-referenced public meeting on July 27, 2006, before the Commissioners. PGE/400/Lobdell-Outama/22 at lines 4-10; PGE/403/Lobdell-Outama and PGE/404C/Lobdell-Outama. The slide presentation by PGE is PGE Exhibit 404. ICNU also offered a transcription of this public meeting as ICNU Exhibit 703. As the transcript shows, the comments from the

Commission and Staff were supportive. Mr. Galbraith said:

> At the quarterly power supply meeting staff has been supportive of what we view as an expansion of this short-term purchasing strategy. You're essentially starting to layer in purchases over a longer time frame, and we're supportive of that.

ICNU/703/10 at lines 18-22. PGE continued to discuss its Mid-Term Strategy in its IRP and its Quarterly Power Supply Update ("QPSU") meetings. PGE/400/Lobdell-Outama/22 at line 13 – 25 at line 13. Also, many of the transactions at issue in this docket were included in past AUT proceedings (PGE/400/Lobdell-Outama/24 at line 18 – 26 at line 9) and at no time during any prior proceeding did CUB or ICNU object or express concerns regarding either the transactions or the Mid-Term Strategy. PGE/400/ Lobdell-Outama/25 at line 9 – 26 at line 9; PGE/408 (CUB and ICNU Data Responses admitting no prior objections.) In addition, Staff asked for an update in 2010 at a QPSU meeting and PGE provided it at the next QPSU meeting. PGE/406C.

The Mid-Term Strategy was specifically addressed and discussed in PGE's last IRP docket, LC 48, filed in 2009. PGE/400/Lobdell-Outama/22-24. CUB and ICNU did not comment on the Mid-Term Strategy in Docket LC 48, or in any previous AUT docket, even though transactions made under the Mid-Term Strategy were included in the previous two AUT dockets. PGE/400/Lobdell-Outama/22 at line 19 – 26 at line 9; PGE/408.)

Since before the inception of the Mid-Term Strategy, PGE has communicated with the Commission, Commission Staff, CUB, and ICNU regarding the reasons for the Mid-Term Strategy, the scope of the Mid-Term Strategy itself, and the implementation of the Mid-Term Strategy. The only comments received prior to this docket were positive. The Mid-Term Strategy has been successful at doing exactly what it was designed to do – decrease the volatility of customers' retail prices by decreasing the Net Open Position of

PGE's portfolio. It is opportunistic at best for CUB and ICNU to propose an adjustment to power costs for purchases made in compliance with the Mid-Term Strategy.

V. The denial of PGE's hedging costs would be seen as a hindsight adjustment by the investment community with far-reaching financial impact, which may hurt customers.

A decision denying hedging costs that were part of the Mid-Term Strategy would be viewed as a hindsight adjustment by the investment community. PGE/300/Pope-Valach/7 at lines 19 – 8 at line 2.) As Mr. Stoddard noted, "We know this is a hindsight adjustment, because let's just do a quick check. If natural gas prices had stayed above $10 as they had been in 2008, would we be here? I don't think so." Hearing Transcript/Stoddard/74 at lines 1-4; *see also* PGE/500/Stoddard/10 at lines 1-8.

A disallowance of PGE's hedging costs would have both direct and indirect financial impacts. PGE/300/Pope-Valach/8 at line 12 – 9 at line 11. As discussed in the testimony of Maria Pope, Chief Financial Officer, and William Valach, Director of Investor Relations, the immediate financial impact on PGE of the suggested disallowance is even greater than the proposed disallowance amount, as PGE would be forced to recognize the expense (i.e. the costs) in 2011 or subsequent periods when hedges beyond 2012 expire. PGE/300/Pope-Valach/1. ICNU's suggested disallowance would have a direct impact on PGE's immediate finances that would likely cause a decline in PGE's stock price and thus affect the cost of raising equity. A loss in investor confidence can impact PGE's credit rating, which could result in increased costs of capital, higher collateral costs for trading, and a general decline in PGE's access to credit. PGE/300/ Pope-Valach/8 at line 12 – 12 at line 9; PGE/500/Stoddard/9 at lines 13-20. A disallowance of hedges made in compliance with PGE policies that were disclosed in past regulatory proceedings would signal the investment community that regulatory risk is high and unpredictable in Oregon, which also would have deleterious consequences for PGE's financial condition. PGE/300/Pope-Valach/3 at lines 1-3, 10 at line 1 – 11 at line 4 and PGE/302/Pope-Valach/6-7 (Moody's Investors Service, *Ratings Methodology: Regulated Electric and Gas Utilities*). A retroactive disallowance of the costs associated with PGE's 2007 and 2008 hedges, which were in compliance with PGE's disclosed policy, to which no one objected, creates a significant disincentive for PGE to hedge. Without such hedges, customers will be exposed to the volatility of market prices, particularly as PGE continues to be short on its load requirements for both power and gas. PGE/500/Stoddard/9 at lines 13-20.)

PGE has shown that a retroactive adjustment is not appropriate. If the Commission desires to address hedging policies on a going-forward basis, we suggest that the Commission open a new docket to do so. PGE would actively participate in a collaborative process to discuss appropriate hedging policy guidelines on a going-forward basis as an effective way to deal with any Commission concerns.

VI. PUC Staff reviewed and supports PGE's power costs, including its hedges.

PUC Staff did not propose any adjustments to PGE's power costs as forecast in this docket. Staff/100/Durrenberger. It is noteworthy that Staff's testimony in the PacifiCorp TAM docket (Docket No. UE 227) supports PGE's hedging strategy here. In the PacifiCorp docket, PUC Staff noted that PacifiCorp's hedges entered into during 2007 and 2008 were prudent because "in the context of what was known at the time, specifically that natural gas prices were increasing every year and the domestic supplies of gas were forecast to be in decline, that it was prudent [for the utility] to enter into contracts to lock down long term supply at the then current market price of gas." Docket UE 227, Staff/300/Durrenberger/10 at lines 9-15.

VII. What ICNU and CUB want the Commission to do is adopt a hedging policy and substitute it, retroactively, for the Company's policy.

ICNU has proposed a specific, programmatic hedging policy that it advocates the Commission adopt. CUB's recommendation is unclear. CUB first expresses concern about all hedges beyond 36 months, arguing that the local gas distribution company, Northwest Natural Gas, only hedges out three years so PGE should do that as well. At the hearing, CUB changed its position from 36 months to 48 months, without changing any other aspect of its testimony, thus leaving its proposal unsupported even by its own testimony. In addition, CUB proffered a five-year inclining block programmatic hedging strategy in its testimony. CUB/100/Jenks-Feighner/4.

Regardless of the specifics or the lack of clarity of the proposals, it would not be appropriate for the Commission to adopt a hedging policy for PGE in this docket. As Staff stated in its UE 227 testimony, "Staff believes that it is inappropriate for the Commission to get in to the business of requiring a particular specific hedging program or strategy." Docket UE 227, Staff/300/ Durrenberger/11 at lines 8-10. Staff further commented, "For the same reason, that the Commission should not be telling PacifiCorp how to hedge power costs, I think ICNU's hedging adjustment should be rejected. The hedges appeared to be executed in accordance with a comprehensive risk management policy." *Id.*, at lines 15-19. The same is true in this docket for PGE. This is not the place for adoption of a new hedging policy.

There is little, if any, factual support for the proposed policies. What testimony CUB and ICNU have provided is undercut by the fact that their witnesses lack practical expertise in utility hedging. By contrast, Mr. Stoddard, who has direct experience and expertise in electric utility hedging programs, opined that the Mid-Term Strategy was "consistent with best practice in the utility industry." PGE/500/Stoddard/29 at lines 3-4. The evidence has shown that the Mid-Term Strategy was, and is, a prudent and successful practice for PGE to manage the volatility of power costs.

VIII. ICNU has failed to establish that PGE's hedging strategy was imprudent; its suggested disallowance should be rejected.

A. ICNU has failed to establish that PGE's policy or execution was imprudent.

ICNU, through Mr. Schoenbeck, made broad assertions with little, if any, support for its opinions.

1. Mr. Schoenbeck lacks experience in hedging policies.

Mr. Schoenbeck lacks sufficient education or experience in formulating hedging policies for an electric utility to provide a meaningful opinion on the subject. Other than attending two seminars in the late 1980s and purchasing two textbooks on hedging, Mr. Schoenbeck has no formal education, training, or real world experience in hedging for electric utilities. ICNU/109/Schoenbeck Deposition/9 at lines 11-23; 9 at line 24 – 10 at line 21; 12 at lines 7-13. Indeed, Mr. Schoenbeck has never been hired by a utility to formulate a hedging policy, nor has he ever formulated a hedging policy for an electric utility. *Id.* 21 at line 23 – 22 at line 6; 32 at lines 7-20. While Mr. Schoenbeck claims thirty years of experience in the utility field, none of it is relevant here. Mr. Schoenbeck has primarily worked for large industrial customers – "energy-intensive users" -- regarding their procurement needs, not a regulated utility with a complex portfolio of multiple energy and reliability risks that is inclusive of market volatility of both gas and power. ICNU/109/Schoenbeck Deposition/14 at lines 2 – 21; 21 at line 17 – 22 at line 1.

2. Mr. Schoenbeck fails to provide data, facts or any support for his opinions.

As more fully discussed in PGE's Motion to Strike portions of Mr. Schoenbeck's testimony and in PGE's Reply in Support, Mr. Schoenbeck fails to provide support for his positions.

a. No evidence that other comparable utilities limit their hedges to less than 48 months.

Mr. Schoenbeck fails to identify any other comparable electric utilities that limit their hedges to less than 48 months. ICNU/108/Schoenbeck/12 at line 24 – 13 at line 2. Instead, it is noteworthy that ICNU Exhibit 701 shows that Southern California Edison's 2008 auction sought "financial-hedge products for up to <u>59 months</u> in duration." ICNU/701/2 (emphasis added). Mr. Schoenbeck has also failed to provide any analysis regarding:

- The risks that other (named and unnamed) utilities he bases his recommendation on were hedging;
- How the respective risk profiles of these utilities compare to PGE's;
- How the markets these utilities have access to compare to PGE's; or
- Any other fundamental analysis of why any of the other utilities' hedging strategies would be appropriately applied to PGE.

Without this information, it is impossible to make comparisons to PGE's Mid-Term Strategy. Moreover, PGE established that it is sound practice for a utility to use hedging to manage risk for its customers beyond 48 months. Hearing Transcript/Stoddard/65 at line 23 – 67 at line 18.

b. No evidence that monthly and quarterly strips were liquid in 2007 and 2008 for delivery in 2012.

Likewise, Mr. Schoenbeck and ICNU do not provide any data to establish that the monthly and quarterly products they contend PGE should have purchased were liquid beyond 24 months. Instead, Mr. Schoenbeck again contends that the basis for his opinions cannot be disclosed because it is confidential information that is subject to protective order(s). ICNU/108/Schoenbeck/5 at lines 21-22, 12 at lines 1-5; PGE/600

(ICNU Response to PGE Data Request Nos. 015, 017, and 018). In his surrebuttal testimony, Mr. Schoenbeck points to the "availability" of monthly and quarterly strips in non-comparable auctions by Southern California Edison. ICNU/108/Schoenbeck/7-8. As PGE discussed, any product can be made available for a price. However, the key factor is liquidity (with consideration for the ease with which a product can be transacted and the transparency of the pricing). Hearing Transcript/Outama/32 at lines 2–8. Mr. Schoenbeck's two examples fail to establish the liquidity of monthly and quarterly strips in markets accessible to PGE in 2007 and 2008.

The distinction between availability and liquidity is fundamental. Hearing Transcript/Outama/32 at lines 2-16. Traders typically operate in markets that feature a "bid" side and an "offer" side. The difference between the bid and offer prices, the bid-offer spread, and the depth of the market provide an indication of the liquidity of the market. The narrower the spread, the more liquid is the market. When Mr. Schoenbeck establishes "availability," he has only accounted for half of the market, the offer side. Hearing Transcript/Outama/32 at lines 2-16. Without knowledge of the bid side of the market, there is no basis to establish whether an observed offer price is fair or reasonable.

The data from the SCE auction is irrelevant for assessing liquidity in the markets on which PGE relies. Hearing Transcript/Stoddard/61 at line 22 – 62 at line 6. In particular:

- The SCE auctions in 2010 and 2011 reveal nothing about liquidity in 2007 and 2008, the years at issue (Hearing Transcript/Outama/29 at line 16 – 30 at line 10);

- SCE is located in Southern California and is subject to completely different market dynamics than PGE, with different delivery locations (Hearing Transcript/Outama/30 at lines 11-20; 62 at line 19-63 at line 5);
- The SCE auctions were for a different product, for a different quantity, and for a different tenor (Hearing Transcript/Outama/29 at line 16 – 30 at line 10 and 31 at lines 11–21; Stoddard/61 at line 22 – 63 at line 5);
- "Interest" and responses to SCE's RFP do not demonstrate "liquidity" (Hearing Transcript/Outama/107 at lines 13-20).

For all of these reasons, Mr. Schoenbeck's testimony should be either stricken, or given no weight.

In contrast to Mr. Schoenbeck's lack of evidentiary support, PGE confirmed based on ICE data and established through the testimony of witnesses with relevant experience that, while yearly strips were traded in 2007 and 2008 in liquid markets connected to PGE, monthly and quarterly hedging products were not. ICNU/110/Schoenbeck/11–12 and 33–34 (PGE Responses to DRs) and PGE/500/Stoddard/19 at lines 1–16; Hearing Transcript/Outama/35 at line 24 – 37 at line 3 (as corrected); Stoddard/159 at line 17 – 160 at line 25.

3. ICNU, Mr. Schoenbeck and CUB show a lack of understanding of electric and gas hedging by contending that PGE over hedged gas in the early years.

ICNU, Mr. Schoenbeck, and in some respects CUB, criticized PGE's hedging strategy, contending that it was improper for PGE to purchase gas for delivery in future years while not also purchasing power. As explained in the testimony of PGE's witnesses (for example, PGE/400/Lobdell-Outama/13 at lines 8–20, and Hearing Transcript/Outama-Lobdell/44 at line 19 – 45 at line 13), PGE hedged gas before power for two main reasons. First, the market for gas products is liquid farther out than the market for power. Second, it is more efficient for PGE to hedge using gas than it is using power. PGE's witnesses explained that because PGE has very efficient gas generating plants, PGE is able to hedge more of its open position, resulting in greater volatility reduction, with gas purchases rather than with power purchases of the same dollar magnitude. There is more "bang for the buck" using gas, and that is why PGE prefers to first reduce its gas open position. Hearing Transcript/Outama-Lobdell/44 at line 19 – 46 at line 13; and Hearing Transcript/Stoddard/67 at line 22 – 69 at line 2. In fact, were PGE to have used ICNU's proposed approach and hedged both gas and power at the same time, PGE's power costs would be higher in this docket. Hearing Transcript/ Outama-Lobdell/46 at line 14 – 47 at line 15.

4. ICNU and Mr. Schoenbeck failed to appreciate a recognized hedging strategy in contending that PGE over hedged Q2.

ICNU and Mr. Schoenbeck criticized PGE's hedging strategy contending that PGE had imprudently "over hedged" the second quarter of 2012 with a "long gas position." ICNU/100/Schoenbeck/7 at line 13 – 8 at line 9. As Messrs. Outama and Lobdell explained, PGE never hedged more gas than it needed <u>annually</u>, and PGE was short energy in the second quarter of every year, because PGE's hydro resources do not satisfy all of its load requirements. PGE/400/Lobdell-Outama/31 at line 6 – 32 at line 12. In fact, PGE used Q2 gas for the dual purpose of a hedge for the gas needed in other quarters as well as the power risk in Q2. Hearing Transcript/Outama/47-50.

PGE's strategy to use Q2 gas to hedge its gas needs in other quarters is a well-known hedging strategy called "Stack and Roll," which ICNU and Mr. Schoenbeck failed to recognize despite the fact that it is documented in one of the textbooks Mr. Schoenbeck keeps on his shelf. PGE/503 ("The U.S. Power Market, Restructuring and Risk Management" (1997); ICNU Response to PGE Data Request No. 009 (re: titles to

Mr. Schoenbeck's books)). As Mr. Stoddard explained, using a highly correlated hedge in one period of time to match a need in another time period, and shaping those hedges as the delivery date nears and liquidity improves, is a prudent strategy, recognized in the industry. Hearing Transcript/Stoddard/70 at line 22 – 73 at line 15.

Mr. Schoenbeck also failed to address the use of forward Q2 gas purchases to hedge Q2 power risk. Mr. Schoenbeck acknowledged that gas and power prices are highly correlated, and that using one product to hedge the risk of the other can be effective. ICNU/109/Schoenbeck Deposition/65 at line 21 – 66 at line 14; 124 at line 3 – 125 at line 6. But because he never correctly identified PGE's total portfolio risk to both power and gas, he was unable to properly look at the transactions and "match" them to the risk they were to hedge. PGE pointed this out in its rebuttal testimony, but Mr. Schoenbeck did not address this obvious flaw in his approach in his surrebuttal testimony.

5. ICNU originally recommended a programmatic approach, but never applied it. Later, ICNU retreated from its programmatic approach. Yet ICNU fails to acknowledge that PGE's hedges fall within ICNU's recommended parameters.

Originally, ICNU contended that PGE should apply a programmatic approach and hedge 20% of its volumetric targets per year. *See* ICNU/102/Schoenbeck/18, Table entitled "ICNU Volumetric Hedging Strategy." Though Mr. Schoenbeck suggested this mechanistic hedging program, he did not calculate his proposed adjustment using that mechanistic approach. Then, in his deposition, he somewhat backed away from his programmatic approach, saying that 20% per year was not "a hard-and-fast" limit, but rather a "kind of a reasonable target." ICNU/109/Schoenbeck Deposition/70 at line 20 – 71 at line 5. Finally, in his surrebuttal testimony, Mr. Schoenbeck backed away from his mechanistic programmatic approach altogether and testified that hedging between 15-25% per year of PGE's net open position would be reasonable. ICNU/108/Schoenbeck/12 at lines 8-14. While touting a programmatic approach, ICNU criticizes PGE's cessation of hedging in late 2008 and 2009. As discussed by Messrs. Lobdell and Outama, it was reasonable given the financial crisis happening at the time and the fact that the gas industry was in flux due to the revelation that domestic gas supply would be significantly greater than originally expected due to "fracking." PGE/400/Lobdell-Outama/39 at line 13 – 40 at line 14. To have blithely continued "programmatic" purchasing during this time would have been imprudent, and PGE chose instead to suspend its purchases until the gas market found its footing. *See* Hearing Transcript/Stoddard/59 at line 18 – 60 at line 11.

More importantly, Mr. Schoenbeck never acknowledges that for the years in question, 2007 and 2008, PGE closed its Net Open Position for 2012 exactly within Mr. Schoenbeck's recommended targets of 15%-25% of NOP. *See* ICNU/108/Schoenbeck/12 at lines 8-14. In 2007, PGE hedged 19% of its NOP for 2012; and in 2008, PGE hedged 23% of its NOP for 2012. PGE/400/Lobdell-Outama/37 at line 5, Table 2.

B. Despite its shifts in position, ICNU has never adjusted its proposed disallowance to match its revised arguments.

Even though its position has continually shifted, ICNU has never changed the amount of its proposed adjustment. ICNU's proposal is not a legitimate attempt to make policy based on reasoned argument and supporting data, but instead is an opportunistic attempt to create any support for a cost disallowance.

Mr. Schoenbeck admits he did not use his recommended targets to quantify his suggested adjustment. ICNU/108/Schoenbeck/12 at lines 11-12. ICNU's proposed disallowance does not reflect the policy it urges the Commission to adopt. For example, in criticizing PGE's supposed "'front end' loaded method," ICNU argued that PGE hedged too much gas too soon. ICNU/100/Schoenbeck/9 at lines 8-10. However, the testimony of Messrs. Outama, Lobdell and Stoddard demonstrates that if PGE had hedged more power sooner and less gas, in conformity with Mr. Schoenbeck's recommendations, it would have resulted in a higher quantity of hedges to obtain the same risk reduction. Hearing Transcript/Outama-Lobdell/46 at line 14 – 47 at line 15. As Messrs. Outama, Lobdell and Stoddard testified, PGE has gas plants that can efficiently convert gas to power, and consequently hedging gas first, up to PGE's annual gas requirements, is a more cost-effective hedge for PGE than hedging power first. Hearing Transcript/Outama-Lobdell/44 at line19 – 47 at line 11; Hearing Transcript/Stoddard/67 at line 22 – 69 at line 2. There is no support for a contrary position, other than Mr. Schoenbeck's unsupported criticism. Mr. Schoenbeck has not demonstrated that eliminating PGE's actual gas hedges in 2007 and 2008 and replacing them with power hedges at that time would have more cost effectively reduced volatility for customers, nor did Mr. Schoenbeck apply his approach when calculating his proposed disallowance.

IX. CUB's position is also unsupported and should be rejected.

CUB has provided little, if any, analysis to support its position, and its testimony should be quickly dispensed with for that reason alone. The only point of reference CUB cites in its testimony is Northwest Natural Gas ("NWN"). Based solely on NWN, CUB postulated that PGE should not hedge more than 36 months out, though CUB's testimony also contained a proposed programmatic five-year hedging approach. CUB/100/Jenks-Feighner/4. The testimony contains no analysis as to whether the risk profile of NWN is in any way comparable to PGE's risk profile. There is no analysis of how NWN's hedging strategy was derived, or how their strategy fits into NWN's other long-term planning goals. There is no analysis of how the different purchasing strategies of NWN and PGE result in differential access to trading counterparties. And while mentioned, CUB minimizes the fact that NWN has just entered into what is effectively a 30-year hedge for some of its gas supply in the form of the Encana purchase. The NWN example is not supported, and is inapposite.

At the hearing in this matter, CUB changed its testimony. Rather than recommending disallowance of hedges beyond 36 months, CUB now recommends disallowance of hedges beyond 48 months. This altered proposal leaves CUB in the position of having no testimony to supports its current recommendation. CUB claims NWN's 36-month hedging practices should govern, but now agrees that hedges up to 48 months are proper. There is no support in the record for CUB's position.

X. Conclusion

This docket is about PGE's Mid-Term Strategy. PGE has shown that the strategy and the purchases made under that strategy were prudent. PGE has shown that the strategy was thoughtfully conceived and based on sound analysis. It was well-communicated. It was carefully executed. While there have been plenty of opportunities for CUB and ICNU to question or challenge the Mid-Term Strategy, they chose not to do so until now, after several years of the strategy being in practice. The Mid-Term Strategy did just what it was designed to do: decrease volatility in customer prices by reducing power cost volatility. The claims for a disallowance of prudently incurred power costs are unsupported. PGE's 2012 power costs should be approved.

DATED this 14th day of September, 2011

Respectfully submitted,

DCTingey for

Lisa M. Kaner, OSB No. 881373
Shareholder
Markowitz, Herbold, Glade & Mehlhaf, PC
1211 SW 5th Ave, Suite 3000
Portland, OR 97204
503-295-3085 (telephone)
503 323-9105 (facsimile)
lisakaner@mhgm.com

DCTingey

Douglas C. Tingey, OSB No. 044366
Assistant General Counsel
Portland General Electric Company
121 SW Salmon Street, 1WTC1301
Portland, OR 97204
503-464-8926 (telephone)
503-464-2200 (facsimile)
doug.tingey@pgn.com

CERTIFICATE OF SERVICE

I hereby certify that I have this day caused **OPENING BRIEF OF PORTLAND GENERAL ELECTRIC COMPANY** to be served by electronic mail to those parties whose email addresses appear on the attached service list for OPUC Docket No. UE 228.

Dated at Portland, Oregon, this 14th day of September, 2011.

DOUGLAS C. TINGEY, OSB #044366
Assistant General Counsel
Portland General Electric Company
121 SW Salmon St., 1WTC1301
Portland, OR 97204
(503) 464-8926 (Telephone)
(503) 464-2200 (Fax)
Doug.tingey@pgn.com

SERVICE LIST
DOCKET UE 228

Gordon Feighner (C) CITIZENS' UTILITY BOARD OF OREGON gordon@oregoncub.org	Robert Jenks (C) CITIZENS' UTILITY BOARD OF OREGON bob@oregoncub.org
G. Catriona McCracken (C) CITIZENS' UTILITY BOARD OF OREGON catriona@oregoncub.org	Kevin Higgins, Principle (C) ENERGY STRATEGIES, LLC khiggins@energystrat.com
Irion Sanger (C) DAVISON VAN CLEVE, PC mail@dvclaw.com	S. Bradley Van Cleve (C) DAVISON VAN CLEVE, PC mail@dvclaw.com
Greg Bass NOBLE AMERICAS ENERGY SOLUTIONS gbass@noblesolutions.com	Ed Durrenberger (C) OREGON PUBLIC UTILITY COMMISSION ed.durrenberger@state.or.us
Stephanie S. Andrus, Assistant AG (C) DEPARTMENT OF JUSTICE Stephanie.andrus@state.or.us	Donald Schoenbeck (C) REGULATORY & COGENERATION SERVICES, INC. dws@r-c-s-inc.com
Gregory M. Adams, Attorney (C) RICHARDSON & O'LEARY greg@richardsonandoleary.com	