BEFORE THE OREGON PUBLIC UTILITY COMMISSION

DR 10/UE 88/UM 989

In the Matters of	**Utility Reform Project (URP)**
The Application of Portland General Electric Company for an Investigation into Least Cost Plan Plant Retirement. (DR 10)	**Exhibit 300**
Revised Tariffs Schedules for Electric Service in Oregon Filed by Portland General Electric Company. (UE 88)	
Portland General Electric Company's Application for an Accounting Order and for Order Approving Tariff Sheets Implementing Rate Reduction. (UM 989)	

SURREBUTTAL TESTIMONY OF JIM LAZAR

Phase I

August 1, 2005

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Q. What is the purpose of your surrebuttal testimony?

A. I respond to the Company's Rebuttal Testimony, primarily that of witnesses Hager, Tinker, and Schue. These witnesses challenge the quantification of the refund due to customers.

Q. What are the principal issues that these witnesses raise?

A. They raise the following issues:

1. Alleged declining balance of Trojan investment over the 5.5 year period beginning April 1, 1995
2. The Trojan balance used in the Commission's UE-88 decisions.
3. Use of a pre-tax cost of capital to consider the time value of money
4. Inclusion of Deferred Income Tax in the refund amount.
5. 17-year return of, but not on, Trojan balance.

Q. Do you concede any of these issues?

A. The second issue may be legitimate. The remainder are attempts to confuse the Commission on a relatively simple issue of a refund due to consumers.

Declining Trojan Investment

Q. Please begin with the issue of the asserted declining Trojan investment. Why is this issue flawed?

A. While the Company did reduce the amount of Trojan carried on its books over this period, it did not reduce the charges to customers to reflect this reduction. Customers continued paying rates based on the amount at the time of the rate decision in 1995.

Q. In fact, did ratepayers pay even more than you calculated?

A. Yes. The 1995 Trojan balance was used to set rates. If sales volumes increased or decreased after that time, PGE's revenue for Trojan would track sales. While the Company's costs of carrying Trojan may have been declining, as the investment was amortized, the amount paid by ratepayers did not decline. It was set at the 1995 level and remained there.

Q. What happened to PGE sales between 1995 and 2001?

A. In 1995, PGE retail sales totalled 17.56 billion kilowatt-hours. In 2001, those had increased to 19.04 billion kilowatt-hours. Therefore, PGE consumers were paying about 8% MORE than the amount I assumed by 2001, even though PGE's cost of carrying the Trojan investment had declined.

Q. What finding should the Commission make on this issue?

A. The Commission should find that my original assumption was conservative. It should not be adjusted downward. The fact that PGE's costs (balance of Trojan investment on its books) declined during the 5.5-year period is irrelevant to measuring what the PGE consumers paid during this period.

Trojan Balance in the UE-88 Decision

Q. At page 3 of their rebuttal testimony, the PGE witnesses assert that the Commission actually used a lower rate base than you assumed in your direct testimony. Do you agree?

A. Yes. It would be logical that the Commission would have used the average rate base, not the beginning of period rate base.

Q. What adjustment should be made to your calculation?

A. I accept the Company's estimate that my calculation overstates the refund by $62 million. That would reduce my recommended refund from $806 million to $744 million.

Pre-Tax Cost of Capital

Q. What is the issue surrounding your use of the pre-tax cost of capital in computing the amount of the refund?

A. Ratepayers pay not only the actual cost of debt and equity incurred by PGE, when an asset is included in rates, but also pay state and federal income taxes in rates. This is done so that the Company's income, after paying state and federal income taxes, is sufficient to cover those debt and equity costs. My calculations recognized this cost and computed a refund on the same basis.

Q. Why is the Company's testimony that the overall rate of return be used inappropriate?

A. The effect of this would be to allow the Company to keep (for shareholders) the income tax payments paid by customers during the overcharge period. If PGE refunds the amount I have identified (as modified above), it will have a reduced federal and state income tax liability, and will avoid tax payments in the future.

Q. What would be the effect of your proposal?

A. Under my proposal, PGE's net worth would decline by the amount of the refund, less the tax benefits of paying that refund. Mathematically, it is equivalent to the use of the overall rate of return that PGE witnesses advocate.

Q. What would be the effect of the PGE proposal?

A. Under PGE's proposal, the Company would get to keep the taxes paid by ratepayers during the overcharge period on the income consisting of the Trojan return on investment. The amount of the refund, and its impact on the Company's net worth, would not match the contribution paid by ratepayers. It is improper to allow PGE to turn a “refund” into a “profit center.”

Q. Is the Company's argument that this is the interest rate used on deferrals generally relevant?

A. No. The deferral interest rate is appropriate for amounts where it is not knowable in advance whether the Company will over-collect or under-collect allowed costs. The natural gas Purchased Gas Adjustment mechanism for Northwest Natural Gas is an example of this. In that situation, use of the overall rate of return provides reasonable interest. As long as the overcollections and undercollections are relatively balanced, this provides fair treatment over time as customers enter and leave the customer base.

These Trojan overcharges were not inadvertent, they were quite planned and deliberate. They are not “balanced” with under-collections, either during the 1995-2000 time period or since. That is a fundamental difference. The justifications for using the overall rate of return do not apply here. Ratepayers paid taxes on the overcharge amounts and are entitled to a refund of those overpayments at the same rate that was used to calculate the return on Trojan investment that ratepayers were required to pay by OPUC Order No. 95-322.

Q. What method should the Commission approve?

A. The Commission should approve my calculations, using the pre-tax cost of capital.

Deferred Income Tax

Q. Why should deferred income taxes be refunded at the time of project termination?

A. Deferred income taxes are amounts that ratepayers paid to PGE to cover income taxes due when Trojan was in operation but which were not then paid to the State of Oregon or the United States Treasury due to accelerated depreciation or other timing differences. These payments by ratepayers were held by PGE, to be flowed back to ratepayers gradually over the life of the plant, as the timing differences reversed.

The primary reason for the timing difference is that PGE could claim accelerated depreciation expense for tax purposes (avoiding income tax), but these savings were not flowed through to customers at the time the benefits were received by PGE. This is, therefore, an amount of money paid by ratepayers and held by PGE for the benefit of ratepayers at the time Trojan ceased operation. My testimony is that this amount should be returned to ratepayers.

Q. Why does the termination of the project create an immediate cause for refund of these held amounts?

A. My understanding is that the IRS did not allow flow-through of these amounts while the unit was in service, but I am aware of no requirement for the

Company to hold these amounts after the unit has ended service. Therefore the refund should be contemporaneous with project termination. Since that refund did not occur, interest needs to be added since the date of project termination to the date of the refund.

Q. Why shouldn't these amounts be applied against the unamortized balance of the plant?

A. These amounts have nothing to do with the unamortized balance. They are amounts actually paid associated with the portion of the plant investment that was previously depreciated.

Q. Can you give an analogy of this issue?

A. Yes, but it requires that Oregonians think a bit outside the borders of the state. If you purchase a new tent for $100 at a Fred Meyer store in Vancouver, Washington, you pay $108.40 for it, consisting of $100 for the tent, and $8.40 for sales tax. The store then remits the $8.40 to the State of Washington. If you then decide you don't want to keep the tent, and return it, the store refunds not only the $100 purchase price, but also the $8.40 in tax. This is because the store shows the refund as a reduction in their gross sales, and can reduce future tax payments to the state to reflect that reduction in sales.

This issue is quite the same – customers PAID state and federal income tax when they were unlawfully charged for Trojan return on investment and are entitled to a refund of BOTH the amount of such profits they paid AND the income taxes they paid on such profits. Since the refund is delayed, they should get interest at the same rate that they paid for return and taxes – as that is the ONLY refund amount that would allow them to go out today and buy something (including taxes) of equal value (taking the time value of money into account) as they could have bought for the same amount of money during the 1995 - 2001 overcharge period.

17 Year Return Of, Not On, Trojan

Q. At page 7 of the rebuttal testimony, the PGE witnesses question the cost of capital adjustment based on an assumed present value of a 17-year recovery of the Trojan investment without a return. Is this a legitimate concern?

A. It is speculative to assume that either:

a) The Commission would have allowed a 17-year amortization of the Trojan investment, or

b) The financial community would have allowed PGE to carry a disallowed asset on its books for that many years.

I have assumed that the Commission would have denied recovery of Trojan and that the Company would have taken a one-time write-off of the Trojan investment, purging a non-producing asset from the books. I believe this is a reasonable and prudent assumption.

Summary

Q. What is the combined effect of the adjustments you have discussed?

A. My original recommendation was for a refund amount of $806 million in the recommended methodology, taking into account the effect of the Trojan write-off on the Company's capital structure. That amount would be reduced by $62 million for the beginning-of-period adjustment, to a maximum value of $744 million.

My original recommendation was for a refund amount of $687 million under the "current rate of return" methodology. This approach is also affected by the $62 million adjustment for the beginning-of-period rate base, to $625 million.

So, my rebuttal recommendations are for a refund amount of $744 million. I also have provided support for a refund of $625 million. I believe that $744 is the best value for the Commission to rely upon.

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SURREBUTTAL TESTIMONY OF DANIEL W. MEEK

Phase I

August 1, 2005

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Q. Are you the same Daniel W. Meek who submitted testimony earlier in this case?

A. Yes.

Q. What is your Surrebuttal testimony in Phase I of this proceeding?

A. My testimony is stated below, in a normal narrative format, with no unnecessary questions interspersed to simulate a direct examination.

I. RESPONSES TO PGE.

A. PGE DISREGARDS THE ENORMOUS RETURN ON INVESTMENT ENJOYED BY THOSE WHO HELD ITS STOCK DURING THE 5.5-YEAR PERIOD.

PGE/6800 returns to discussion of the appropriate rate of return for investors and how "investors in 1995 would have demanded a slightly higher return on PGE's equity." PGE/6800/9. What PGE entirely disregards is the fact that these investors in PGE received a huge return, far above any reasonable return on investment, when Enron bought PGE in 1997. According to the Final Staff Report (April 11, 1997) in UM 814, Enron paid a "premium 47% above PGC's market price to PGC shareholders."

> The premium is calculated by taking the difference between PGC's market stock price of $28.125 per share and Enron's market stock price of $41.375 per share on the stock trading day immediately prior to the merger announcement and multiplying this difference by the number of PGC outstanding shares. This calculation results in nearly a $677 million premium to PGC shareholders.

Id., note 1. And, after the Enron takeover, PGE no longer needed to attract equity investment.

B. PGE DISREGARDS THAT IT WAS ALLOWED TO EARN A RETURN ON TROJAN WHILE IT OPERATED, HOWEVER BADLY.

PGE 6800/12-13 seeks to distinguish Trojan from the abandoned generating plants noted in the Testimony of Jim Lazar. PGE states that reference to these plants is inapt, because they "were all discontinued before construction was complete, whereas Trojan provided service for many years before PGE closed it in 1993." During the entire period that Trojan operated, however poorly (as documented in OPUC Order No. 95-322), it was included in ratebase, and PGE earned a return on investment on it. After Trojan permanently closed, it became similar to any plant not operating, such as those that were not completed. Further, the Oregon courts concluded that ORS 757.355 applies equally to plants never finished and plants prematurely closed.

In addition, PGE seeks to rewrite the history of Trojan in rates, claiming that the only reason it was assigned a life of 35 years was because "nobody could foretell precisely how long Trojan would be economic to operate." The OPUC adopted a 35-year life for Trojan, because that was part of its analysis that PGE's investment in the plant was a prudent one. If PGE had come to a PUC and said, "Now put Trojan in ratebase, but nobody knows how long it will be economic to operate," any competent Commission would have rejected that proposal.

C. PGE TOUTS RATEMAKING TO REWARD FAILURE.

PGE 6900/20 continues to tout a ratemaking model that rewards failure. PGE's model would encourage utilities to build and maintain plants poorly, so that they fail early, as did Trojan. Then, according to PGE, the utility should continue to earn profits on the plants that fail early, plus profits on the plants the utility builds to replace the failed plants. The way to maximize profits under this system is to build and maintain plants poorly, as that will maximize the size of the ratebase and, thus, profits.

If a utility has a plant that is failing or even merely not economical to operate, the regulator can easily induce the utility to close it, without granting the utility a profit on the failing plant. The regulator can remove it from rates entirely, as an imprudent cost, unless the utility closes it (and is rewarded with a return of the remaining investment). If the utility insists upon operating it, the regulator can disallow its cost of operation as imprudent. The alternatives, without granting the utility profits on failing plants, are many.

II. RESPONSES TO STAFF.

A. RESPONSES TO ED BUSCH AND JUDY JOHNSON.

1. STAFF'S PROPOSALS ARE INCONSISTENT WITH LEAST COST PLANNING.

Staff Exhibit 100 postulates a ratemaking philosophy that is inconsistent with least-cost planning. According to them, a utility should earn a return on investment for a plant that "becomes uneconomic compared to other alternatives," along with a return on the plant that replaces it. Thus, the Staff system would reward the utility for allowing a plant to become uneconomic, as that would provide the utility with return on investment bonus (return on the old plant as well as return on the new plant built to replace it).

Further, their testimony fails to note that in OPUC Order No. 95-322 the Commission found that the premature "retirement" (complete breakdown) of Trojan was not a cost-effective decision from the ratepayer point of view. The Commission found that it would have been more economical for PGE to continue to operate Trojan, in a prudent manner, than to close it. Thus, rewarding PGE with a return on its Trojan investment was contrary to least-cost planning, not in support of it. It provided an incentive to prematurely close plants, even if it was not in the best interests of ratepayers to do so.

B. ALL OF STAFF'S PROPOSALS INCLUDE PROHIBITED TROJAN "RETURN ON INVESTMENT."

The Staff-proposed "One-Year Amortization" proposal is actually a proposal for a 5.5-year amortization, with return on investment during the entire amortization period. As shown on Ex. Staff/102/3, the "One-Year Amortization" contemplates a "One-Year Impact" consisting of an increase in revenue requirement of $121.2 million above the revenue requirement adopted in OPUC Order No. 95-322 for the Trojan investment. Since time does not run backwards, such a revenue requirement for the first year (commencing April 1, 1995) is impossible, so the Staff proposal carries forward the unpaid amount into successive years, with a return on it ("interest"). Staff/102/ explains this somewhat. Allowing the unpaid principal to carry forward into successive years, with interest on the balance, is the same thing as a 5.5-year amortization, with return on investment during that period. The Oregon courts have ruled that ORS 757.355 does not allow a return on investment for a non-operating plant, specifically Trojan.

This same problem affects all of PGE's approaches that urge the OPUC to retroactively adopt rates higher in any year than authorized by OPUC Order No. 95-322. The PGE calculations do not merely carry over the balances dollar-for-dollars but apply interest rates or return on those balances as they are carried forward.

Since it is not physically possible to turn back the clock and charge ratepayers more than authorized in OPUC Order No. 95-322, the only remotely reasonable approach similar to that of Staff would be to assume that all of the amounts ratepayers paid for Trojan investment on and after April 1, 1995, would be applied to the return of Trojan investment. If we remove the unlawful component of these calculations (the return on investment or "interest"), the calculation becomes rather simple. OPUC Order No. 95-322 states that the Trojan investment value at the start of the 5.5 year period was $250.7 million. Ratepayers paid PGE at least $60.8 million for Trojan investment annually during the 5.5-year period; see URP/202/3. Thus, ratepayers paid at least $334.4 million for Trojan investment during the 5.5-year period. At the rate of $60.8 million per year, the entire Trojan investment value set forth in OPUC Order No. 95-322 was returned to PGE within the first 4.12 years (49.5 months) April 1, 1995. That would be by May 15, 1999. During the final 16.5 months of the 5.5 year period, PGE charged ratepayers an additional $83.6 million for the Trojan investment.

Thus, applying all of the Trojan investment charges as return of investment, Trojan was fully amortized as of May 15, 1999, and PGE then charged an additional $83.6 million to ratepayers for the Trojan investment. So the starting point for the UM 989 proceeding should not have been a positive $180.5 million for Trojan but instead a negative $83.6 million, at an absolute minimum (disregarding the interest that PGE should have paid ratepayers for the $83.6 million overcharge).

Ordinarily, when utilities owe credits to ratepayers, those credits carry a rate of interest equal to the utility's authorized return on investment. If that policy is applied here, then interest in favor of ratepayers on the excess amount already paid for Trojan should have begun at the time that the full Trojan balance was paid (May 15, 1999, if not sooner). For the following 15 months, ratepayers continued to pay PGE at a rate of at least $5.066 million per month for the Trojan investment, resulting in the overcharge of $83.6 million. The average period such overcharge was outstanding was 8.25 months (half of 16.5 months). Assuming an interest rate of 10%, the interest on the overcharge would be $5.75 million, resulting in a balance owed by PGE to ratepayers on the Trojan investment account of $89.35 million as of October 1, 2000.

Thus, the OPUC should not in OPUC Order No. 02-227 have extinguished ratepayer assets worth far in excess of $180.5 million, should not have diverted $15.4 million in NEIL insurance premium rebates away from the ratepayers who paid the insurance premiums, and should not have created the $36.7 million "regulatory asset" which allowed PGE to charge ratepayers yet another $xxx million. Instead, the OPUC should have done none of the above, while it should have ordered PGE to pay a refund of at least $74 million to ratepayers for their overpayment of the Trojan investment during the previous 5.5-year period.

Staff now claims that the Trojan investment value at the start of the 5.5 year period was $340.2 million. This is contrary to OPUC Order No. 95-322, which stated that the Trojan investment value to be included in rates was $250.7 million). But let's use the $340.2 figure. Since PGE charged ratepayers at least $334.4 million during the 5.5-year period for Trojan investment, this would leave a Trojan investment balance of $6.2 million as of October 1, 2000. Instead, the OPUC passed on a Trojan investment balance, as of that date, of $180.5 million and proceeded to extinguish the "offsetting" ratepayer assets, to divert the NEIL premium rebates, and to allow PGE to charge ratepayers for the newly-invented "regulatory asset." As documented in the UM 989 docket, the net effect of these adjustments on ratepayers was a cost to ratepayers of $211.5 million (present value as of October 1, 2000).

C. DEFERRING RECOVERY OF OTHER COSTS, WITH INTEREST.

Various of the Staff approaches include the hypothetical and retroactive deferring of certain PGE costs of service, so that the assumptions about 1-year or other rapid return of Trojan investment does not cause imaginary "rate shock." This is nothing more than allowing a return on Trojan investment, because Staff's approaches include interest or return on the deferred legitimate costs. Certainly, with a revenue requirement approaching $1 billion, the OPUC could have deferred hundreds of millions of dollars of other costs, while hypothetically allowing PGE to recover its full remaining Trojan investment in a single year, without return. But all of these approaches include return on the deferred costs, so it amounts to nothing more than return on Trojan, albeit via obvious evasionary maneuver.

D. RETURN ON INVESTMENT INCLUDES RETURN ON DEBT.

As noted at Staff/100/25 and Staff/200, a utility's return on investment includes both return on equity and return on debt. An item in ratebase, as was the Trojan investment under OPUC Order No. 95-322, earns a return on investment that is calculated as the average of return on equity and return on debt, weighted by the contribution of each to the utility's capital structure. A "return on debt" is a "return on investment." Debt in a utility consists of the holding of utility bonds, which are an "investment."

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The Utility Reform Project (URP) sponsors and adopts the surrebuttal testimony of Jim Lazar and Daniel Meek filed this date.

Dated: August 1, 2005

Respectfully Submitted,

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DR 10/UE 88/UM 989

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Class Action Plaintiffs sponsor and adopt the surrebuttal testimony of Jim Lazar and Daniel Meek filed this date.

Dated: August 1, 2005

Respectfully Submitted,

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CERTIFICATE OF SERVICE

I hereby certify that I served a true copy of the listed documents by email to the email addresses shown below and by U.S. Mail, first class postage prepaid, to the addresses below, which comprise the service list as shown this day on the web site of the Oregon Public Utility Commission for these dockets.

1. Surrebuttal Testimony of Jim Lazar.
2. Surrebuttal Testimony of Daniel W. Meek.
3. Utility Reform Project Sponsors and Adopts Testimony.
4. Class Action Plaintiffs Sponsor and Adopt Testimony.

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