BEFORE THE PUBLIC UTILTIY COMMISSION

OF OREGON

UE 161

In the Matter of Portland General Electric's 2005 Resource Valuation Mechanism	)))	TESTIMONY OF THE CITIZENS'UTILITY BOARD OF OREGON

My name is Bob Jenks. My qualifications are listed in Exhibit 101.

I. Introduction

In this filing the Commission is being asked to approve a projected increase in PGE's rates of $42 million plus an additional amount of money that has not been publicly released. [1] The cause of this rate hike is an increase in power costs as shown by the Company's Resource Valuation Methodology (RVM). CUB is recommending that the Commission find the Company imprudent with respect to a single purchase power contract and reduce rates by $5.9 Million, and that the Commission require the Company to use independent, publicly-available forward price curves for rate setting purposes.

[1] PGE's April 1 filing projected an increase of $42 million. The Company's June 11th update added to this, but all references to the additional increase were labeled confidential and subject to the protective order. In addition further updates may well add to this amount.

II. The Late January 2001 Contract

A. Background

After closing Trojan in the early 1990s, PGE was left with a severe shortage of power. During its 1995-97 Least Cost Plan, the Company attempted to address this shortage through a combination of purchases and development of additional power plants. The Company proposed a three-year action plan that relied on short and intermediate term contracts, and preparing the site certificates and other work necessary that would allow the Company to, “construct and operate as determined by signposts,” two new combined cycle combustion turbines, Coyote Springs II and Deer Island (PGE 1995-97 Integrated Resource Plan, Technical Report, pages 15-1 and 15-2).

After Enron purchased PGE, the Company began to move away from any planning for new power supply and, in fact, proposed in UE 102 that the Company divest itself of all generating assets. The Company went so far as to hire Merrill Lynch & Co. to be the financial advisor to PGE in connection with the sale of its power supply portfolio (UE 102, Supplemental Application for Approval of Auction Process). This was consistent with Enron’s view that electric utilities should be distribution utilities, and should not be in the power supply business.

In addition, PGE at this time articulated a view that price regulation of markets was inherently counterproductive:

> Competition consistently produces the lowest costs in the long run, which is why so few products or services are price regulated in our society. Only by regulating prices or by imposing an artificial cap or ceiling on prices can the government force suppliers in a competitive market to reduce prices. Further, if these regulated prices or caps are below the suppliers’ actual costs, an additional consequence of the government’s action is to drastically reduce

> the quantities of the product supplied. The result, however well intentioned, is counterproductive to the interests of both customers and suppliers.

UE 102/PGE/100/18, Hirko-Fowler-Alexanderson

> In competitive markets, prices are the central source of information regarding the balance of supply and demand: high prices reduce demand and elicit new supply while low prices do the reverse. Under cost-based regulation, prices fail to perform these essential functions.

UE 102/PGE/200/10, Schnitzer

In September, 1997 PGE submitted a new least cost plan that concluded that the Company should not build new plants due to the opportunities to purchase power on the open market. This plan was adopted with modifications by the Commission in July 1999 around the same time that the legislature passed SB 1149. The rules implementing SB 1149 were then created, and stated that new resources should be put into rates at market.

This is the position that PGE customers found themselves in when the Western Energy Crisis hit. They were served by a utility that had developed an ideological position against government regulation of prices, and that was highly dependent on the wholesale market because it hadn't been developing new power plants for several years.

B. PGE's Actions Were Not Prudent

PGE did not respond to this crisis in a manner that a prudently managed utility looking out for the best interests of its customers should. In late January 2001, PGE purchased three expensive contracts for future power. Two of those contracts were for 2003 and were found to be imprudent by the PUC when it reviewed PGE's 2003 RVM filing. The third contract was not an issue in the 2003 RVM because it was a contact for power for 2004-2006 (UE-161/PGE/200/Lobdell/13). While purchasing this expensive power, PGE was not calling for federal regulators to intervene in the wholesale market and ensure just and reasonable rates. Since April of 2000, PGE trading floor employees had been aware of scams that make the wholesale market less than fair and transparent. Yet the Company did nothing to let regulators know about the potential problems in the market, beyond calling for regulators to allow them to pass the costs of this corrupt market through to customers. In spite of the Company's knowledge of market dysfunction, the Company signed contracts that were not only overpriced, but locked in those high prices for several years. When federal regulators did intervene and establish price caps, the Company did not ask regulators to reprice the contracts that it had signed before federal intervention. In each of these choices, PGE displayed flagrant disregard for the interests of its customers and its responsibilities as a regulated monopoly.

Begin Confidential Material

End Confidential Material

C. PGE Opposed Federal Intervention in the Wholesale Market.

As we have said, after Enron purchased PGE, PGE adopted a position that regulated prices or price caps are counterproductive. February 2, 2001, days after PGE signed the contract in late January, Peggy Fowler attended the Western Governors' Association Energy Policy Roundtable. This gave Ms. Fowler, as PGE's CEO, a chance to raise any concerns the Company had concerning the function of the wholesale market with Spencer Abraham, then Secretary of Energy of the US Department of Energy, Curtis L. Hebert, chairman of the Federal Energy Regulatory Commission (FERC), and Linda K. Breathitt and William L. Massey, FERC commissioners. If PGE had concerns about the dysfunction of the wholesale market – if PGE was concerned about the impact market prices would have on its customers – this would have been the place to raise those concerns. Ms. Fowler did not call for price caps, she did not call for any sort of federal intervention in the dysfunctional wholesale marketplace, and she did not call for FERC to look into these high wholesale prices to determine if there was market dysfunction. She didn't even mention what federal regulators should do. Instead, Ms. Fowler suggested that what was needed was not lower wholesale electricity prices, but higher retail rates. What was important was that PGE needed to send price signals, and pass through to customers the cost of the high priced contracts they had just signed:

> And all our customers have to see price signals. We've talked about that. You've heard the right kind of price signals. Absolutely. That's what gets long-term change and behavior.

Peggy Fowler, CEO of PGE
Western Governors' Association Energy Policy Roundtable 2/2/01

Contrast Ms. Fowler's remarks, to the remarks of Jason Eisdorfer who spoke immediately before her:

> I just sort of wanted to weigh in on the differing opinions on the price caps that I heard from the Commissioners Massey and Hebert. I'm not really sure that price caps properly constructed would cause real instability out there. In fact, they may prevent instability and here's my argument. Right now I think we've heard a lot of folks in the room agree that the market is dysfunctional, it's broken and despite the report that we have today, it may even be corrupted… [FERC] still has the statutory obligation to ensure that rates are just and reasonable. And right now we do not think that FERC is particularly engaged in this. We want to see FERC realistically consider price caps and what will happen if we don't do something in the short-term.

Jason Eisdorfer, CUB
Western Governors' Association Energy Policy Roundtable 2/2/01

We recognize that the price caps Mr. Eisdorfer was referring to were for short-term purchases, not the kind of term purchases reflected in the Late January Contract. However, we also saw how FERC-imposed price caps in the short-term market created market stability and reduced prices for longer-term purchases. More importantly, we think markets work better when the players know that the referee is awake, paying attention, and willing to act. The debate in 2001 over price caps was more than a debate about price caps, it was a debate over whether a regulatory system to insure just and reasonable rates was legitimate.

The issue here is whether PGE had an obligation to demand that regulators use their power to ensure just and reasonable rates by intervening in the dysfunctional wholesale market.

D. PGE Knew The Market Was Not Functioning Transparently But Did Not Report It

It is interesting that at the time PGE signed the Late January Contract, CUB was suggesting to FERC that the market "***may be*** corrupted" (emphasis added). PGE, however, had knowledge that the market ***was*** corrupted. As early as April 2000, PGE knew that Enron was running a "scam," a "ricochet," and "that wacky, double flip-over thing," according to the now famous transcripts of April 2000 to June 2000 from PGE's trading and transmission floor. FERC identified 17 days that PGE assisted Enron in running Death Star, one of Enron's more notorious schemes. The PUC and other bodies have investigated and settled cases with PGE based on whether PGE actions were knowingly fraudulent and by themselves created harm to customers. Our concern is different. PGE's trading floor is a ratepayer asset that should be used to benefit customers. When PGE's traders believe that there is a scam happening in the wholesale market, they have a responsibility to customers to report that scam to their supervisors who have a responsibility to report it up the chain of command and management has the responsibility to report it to the regulators who oversee the wholesale market.

In her December 2003 presentation to the Oregon PUC, PGE CEO Peggy Fowler said that this information should have been reported up the chain of command and that the Company might have acted differently if it had been:

> Looking back, I certainly wish we had made it more clear to employees that they can and should raise questions to a higher level. I'm not sure we

> would have made different decisions at the time, but at least there would have been more discussion around those decisions.

Peggy Fowler at Oregon PUC, 12/11/03

The issue here is not just that PGE should have reported the scams that it knew about to regulators, but that the Company ignored the fundamental problems in the market and locked in multi-year energy contracts that were at prices that were above total retail rates. Since PGE had first-hand knowledge that the market had become corrupt, further reliance on the market through multi-year power purchase contracts without calls for regulatory intervention was irrational. Basic market theory states that markets must be transparent and fair to work properly and to reach the lowest possible clearing price. While PGE may have adopted Enron's ideology that price regulation is bad and markets are good, the real world is not ideal. Markets are only as good as their rules, their regulations, and their enforcement. Because PGE's customers were dependent on the market for a large share of their power, PGE customers had an interest in a fair and transparent market that reached the lowest clearing price. And as a market participant, PGE had a responsibility to do what it could to protect the fairness and transparency of the market.

Mr. Eisdorfer was right when he spoke to the Western Governors Association just days after PGE signed the Late January Contract. The market was corrupt and federal regulators needed to do their job as enforcers of market rules and just and reasonable prices. Mr. Eisdorfer's position was based on suspicion. PGE, on the other hand, either knew that the market was corrupt or should have known that the market was corrupt, but failed to act on behalf of its customers.

F. PGE Did Not Maintain Records Of Its Analysis

This is not a new issue. We have been looking at the issue of PGE contracts signed in late January 2001 during the last three RVMs and one of the big problems is that the Company did not have or maintain evidence of what led it to sign these specific contracts at the time that it signed them, the traditional standard of prudence. When committing customers to more than $40 million in costs, there should be some analysis that was considered when the decision was made. When purchasing power several years in advance, there should be some level of documentation to support the reasoning behind the purchase. When purchasing a product that is not part of a liquid market, it is especially important that the Company retain some demonstration that this is part of a least cost approach to power procurement. PGE lists some factors that they considered (UE 161/200/11-12), but as we have looked at this issue over the last several years we have been struck by the fact that the Company has not been able to support their decision with any real evidence of analysis done at the time of the purchase.

In the 2003 RVM, the Commission reviewed four contracts, including two that were signed on the same day in late January 2001 and ruled the contracts imprudent for 2003. The Commission ruled that the Company had failed to establish that it was prudent to buy high priced contracts in 2001 for 2003.

> PGE has failed to establish the reasonableness of its decision to purchase high-priced power for the remainder to the 2003 calendar year…PGE provides little if any supporting evidence relating to the price trend for 2003 power products or internal company analysis of that advanced market to justify its decision…PGE presents no evidence related to market activity just prior to the other power purchases…In the absence of more complete information and analysis of the market conditions for 2003 power, we have no basis to evaluate the reasonableness of PGE's business decision to buy

> high-cost power during 10 months in 2003 in which there was no indication of power reliability problems.

PUC Order 02-772, pages 8&9

> It is possible that PGE's actions were indeed prudent. The evidence provided, however, does not allow the Commission to reach that decision. The four power contracts as noted in this order were made outside of PGE's routine practices and outside of policies they enunciated in this and prior dockets. The market, while perhaps "nuts" as the company stated, was evolving quickly as noted in the NPPC analysis, which PGE referenced. The company, however, did not provide persuasive evidence why going long in this market, in spite of past practice and policy, was justified.

Commissioner Lee Beyer, Concurring Opinion PUC Order 02-772

The Company was unable to provide evidence to support its late January 2001 purchase of contracts for the 2003 calendar year. There is even less evidence to support that it was prudent at that exact same time to purchase power for 2005.

G. $5.9 Million Should Be Disallowed

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CUB Recommendation on Contracts: The Commission should reduce net power costs by $5.9 million to protect PGE customers from the impact of the Company imprudence associated with the Late January Contract.

III. Subjective Forward Electricity Price Curves

As part of the RVM process, PGE produces a final Monet run in November, which sets the power costs, and therefore the rates, for the upcoming year. The forward electricity price curve used in that run, which has a significant impact on net power cost, is developed by PGE traders after all discovery in the docket is complete. Given the impact this curve has on retail rates, and given the availability of independent price curves, PGE should use these independent curves, rather than its own, to increase transparency in the RVM process.

A. The Forward Price Curves Have A Significant Impact

The forward price curves used in Monet have a significant impact on total power costs and ultimately on rates.

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Exhibit 103 shows the effect of a series of small changes in forward price curves for electricity and gas: shifting the forward electricity price curve up or down 10% for all hours, shifting the forward electric price up or down by 10% for peak hours, and shifting the natural gas prices up or down by 10%. The following table shows the resulting changes in power costs.

Begin Confidential Material

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There are significant dollars at stake over the issue of forward price curves.

B. PGE's Forward Price Curves That Are Used For Setting Rates Are Unverifiable

While there is a great deal of money at stake with the forward electricity price curves, it is impossible to challenge PGE's forward prices curves. They are established internally. There is no documentation supplied to support them and the ones that are used to set rates are filed with the Commission after the Commission has issued an order in the docket. Last year the Commission issued its order in the RVM docket on August 29th and the Company filed its final forward price curve on November 15th, which, of course, was confidential and subject to a protective order. This means that a significant factor in rates has undergone no review, has been subject to no challenges, and cannot be discussed publicly. None of us should be comfortable with this process.

PGE's testimony states that the "trading curves are supplied by the Power Operations Group, which purchases and sells wholesale electricity and gas for PGE, and validated by or Risk Management group." PGE/100/15.

CUB asked the Company to "provide any documents/workpapers/analysis that supports these forward price curves." Exhibit 104 shows the answer. PGE does "not maintain documentation when they develop the forward price curves." PGE traders track the movement of prices, however, because not "every forward month is quoted with certain frequency," PGE traders "use their experience and historical performance of the month in order to derive the price of the month in question."

PGE's Risk Management group then validates these curves by comparing them to "quotes provided by voice brokers, other brokers, and periodicals." If PGE's curve varies from the curves used for comparison, then Risk Management and the Power Operations Groups work to determine if the curve should be changed.

In the case of the April 1st curve, the variation was not greater than 5% and no changes were made in the curve. However, that is not the curve that is used to set rates. When it comes to the forward curve, it is not the PUC that will determine PGE's rates, but it is PGE's Risk Management and Power Operations Group that will set rates well after this case will be concluded.

C. We Should Use Independent Price Quotes For Forward Curves

Recently, in approving the new Bonneville contracts, the parties recognized that there was value in finding an independent source for future power prices. Relying on Bonneville to provide the quotes which then determined the level of benefits that PGE and PacifiCorp customers received from Bonneville was not perceived as a fair process. It was subject to gaming. See UM 926, Order No. 04-292, Appendix A, page 2, May 24, 2004.

We believe the same issue exists with allowing PGE to set unverifiable forward prices that are used to establish retail rates.

Luckily, this problem has an easy fix. PGE already obtains independent price quotes and uses them to validate its own forward electricity price curve. Exhibit 105 is a spreadsheet that shows how PGE's Risk Management group compares the Company's internal forward price curve to other independent sources. Rather than having the Company use the independent sources internally as a point of comparison when coming up with the forward curve, the independent sources should be used as the basis for the forward prices that set rates in Monet.

Exhibit 106 contains PGE's argument that the prices produced by independent brokers are based on data compiled prior to the close of business, while PGE includes data from after the close of business in its projections. Thus, the Company claims, its forward price curves are more current than those produced independently.

Whether PGE's forecasts include a couple more hours or not seems to have little significance. We are using forward curves in November to estimate the prices in the market for every hour between January 1st and December 31st of the following year. To suggest that there is a great deal of difference between 6:00 PM on November 14th and noon on November 14th, when we are projecting what prices will be the following July 14th seems absurd. Given the significance of the forward electricity price curve in setting retail rates for the coming year, the trade-off between an hour or two of extra data and the peace of mind provided by an independently-produced price curve and additional transparency in the RVM process seems negligible.

Using the independent, publicly-available price curves would have the additional advantage that they are public, while PGE's price curves are private and subject to OPUC protective orders. To verify their electricity forward curves, PGE uses three independent, publicly-available sources of curves: TFS, Prebon, and Mega Watt Daily.

CUB Recommendation on Forward Curves: The PUC should order the Company to use in its November filing the average of the three independent, publicly-available electricity curves (TFS, Prebon and Mega Watt Daily) as its forward curve for electricity prices.