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July 21, 2005

OREGON PUBLIC UTILITY COMMISSION
ATTENTION: FILING CENTER
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RE: **OPUC Docket No. UE 165 and UM 1187** - In the Matter of PORTLAND GENERAL ELECTRIC Request for Approval of Schedule 128 to Implement a Hydro Generation Power Cost Adjustment Mechanism and In the Matter of PORTLAND GENERAL ELECTRIC COMPANY Application for Deferral of Costs and Benefits Due to Hydro Generation Variance.

Enclosed for filing in the above-captioned docket is the Public Utility Commission's surrebuttal testimony. This document is being filed by electronic mail with the PUC Filing Center.

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**PUBLIC UTILITY COMMISSION
OF OREGON**

UE 165/UM 1187

**STAFF SURREBUTTAL TESTIMONY
OF**

Maury Galbraith

**In the Matter of
PORTLAND GENERAL ELECTRIC COMPANY Request for
Approval of Schedule 128 to Implement a Hydro
Generation Power Cost Adjustment Mechanism and In the
Matter of PORTLAND GENERAL ELECTRIC COMPANY
Application for Deferral of Costs and Benefits Due to
Hydro Generation Variance**

July 21, 2005

CASE: UE 165 and UM 1187
WITNESS: Maury Galbraith

**PUBLIC UTILITY COMMISSION
OF
OREGON**

UE 165 STAFF EXHIBIT 400

UM 1187 STAFF EXHIBIT 200

Surrebuttal Testimony

July 21, 2005

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Introduction

Q. PLEASE STATE YOUR NAME.

A. My name is Maury Galbraith.

Q. DID YOU PREVIOUSLY FILE TESTIMONY IN THESE PROCEEDINGS?

A. Yes. I sponsored Staff/100, Staff/300 and Staff-PGE/100 in Docket UE 165. I sponsored Staff/100 in Docket UM 1187. My witness qualifications were provided as Staff/101 in each docket.

Q. WHAT IS THE PURPOSE OF YOUR TESTIMONY?

A. The purpose of this testimony is to respond to the Industrial Customers of Northwest Utilities (ICNU) and the Citizens' Utility Board (CUB) opposition to Commission approval of two stipulations, supported by the staff of the Public Utility Commission of Oregon (staff) and Portland General Electric Company (PGE), which would establish a System Dispatch Power Cost Adjustment Mechanism (SD-PCAM) for 2005-2006.

Q. HOW IS YOUR TESTIMONY ORGANIZED?

A. First, I respond to CUB's primary arguments against the SD-PCAM. I then respond to ICNU's primary arguments against the SD-PCAM. Finally, I argue that despite CUB's desire for a broader scope, and ICNU's desire for a narrower scope, the SD-PCAM strikes a reasonable balance between capturing hydro-related costs and excluding unrelated costs.

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Response to CUB's Arguments

Q. CUB CRITICIZES THE SD-PCAM BECAUSE IT USES COMPUTER-MODELED COSTS INSTEAD OF KNOWN ACTUAL COSTS. PLEASE SUMMARIZE CUB'S ARGUMENTS.

A. CUB argues that: (1) the language of the automatic adjustment clause and deferred accounting statues seem to require the use of actual costs, not approximations of actual costs, and (2) from a public policy perspective, the use of actual costs is preferable to modeled costs because they are known costs. (CUB/200, Jenks-Brown/15-17.)

Q. DO YOU AGREE WITH CUB'S ASSERTION THAT WHEN IMPLEMENTING AN AUTOMATIC ADJUSTMENT CLAUSE OR DEFERRAL MECHANISM WE CAN SIMPLY USE KNOWN COSTS?

A. No. Even after-the-fact, the cost and revenue impact of specific events, for example poor hydro conditions or a prolonged thermal plant outage, may be unknown. The cost of poor hydro conditions is not readily identifiable in PGE's accounting system. The cost of these events is known only after estimation and approximation.

Q. CAN YOU POINT TO A RECENT CASE WHERE ACTUAL COSTS WERE UNKNOWN AND PARTIES WERE FORCED TO ESTIMATE OR APPROXIMATE ACTUAL COSTS?

A. Yes. PacifiCorp's Docket UM 995 is a good example. Although all the parties to the case agreed that PacifiCorp's hydro-related costs were prudently incurred, there was significant disagreement about the actual level of those

1 costs. CUB witness Jenks put PacifiCorp's cost of replacing lost hydro
2 generation at \$297 million on a total company basis. (See UM 995, CUB/100,
3 Jenks/47-48.) ICNU witness Falkenberg put PacifiCorp's cost of replacing lost
4 hydro at \$498 million on a total company basis. (See UM 995, ICNU/504,
5 RJF/1.) PacifiCorp witness Widmer corrected the CUB and ICNU estimates.
6 Mr. Widmer put his revised CUB estimate at \$403 million and his revised ICNU
7 estimate at \$570 million. (See UM 995, PPL/501 and PPL/502.) Even after-
8 the-fact we may not know, and may be forced to estimate or approximate,
9 actual costs.

10 **Q. WOULD DESIGNING AN AUTOMATIC ADJUSTMENT CLAUSE OR**
11 **DEFERRAL MECHANISM TO TRACK COST AND REVENUE CATEGORIES**
12 **THAT ARE READILY IDENTIFIABLE IN PGE'S ACCOUNTING SYSTEM**
13 **MAKE IT EASIER TO USE ACTUAL COSTS?**

14 A. Yes, in some respects. As I indicated in my direct testimony, a comprehensive
15 PCA mechanism that tracks all the components of NVPC is preferable to a
16 hydro-only mechanism. (Staff/100, Galbraith/16, Lines 19-20.) One of the
17 benefits of a comprehensive PCA is that NVPC is a well-defined set of costs.
18 (Staff/300, Galbraith/15, Lines 5-12.) On the other hand, it is never easy to
19 separate prudently incurred costs from imprudently incurred costs. This task
20 often requires estimation and approximation. It is simple to use actual
21 accounting costs only after a determination has been made that the costs were
22 appropriately accounted for and prudently incurred.

1 **Q. DOES THE LANGUAGE OF ORS 757.210(1) REQUIRE THE USE OF**
2 **ACTUAL COSTS, OR ALTERNATIVELY PROHIBIT THE USE OF COST**
3 **ESTIMATION AND APPROXIMATION?**

4 A. No. CUB reads the word 'actual' into ORS 757.210(1). In fact, the statute
5 does not refer to 'actual costs.' Contrarily, the statute language refers to
6 incurred costs and earned revenues. We can be nearly certain that a utility has
7 incurred more costs and earned fewer revenues due to poor hydro conditions
8 without knowing, in an accounting sense, the exact dollar impact. Knowing the
9 exact dollar impact requires estimation and approximation. CUB's strict
10 reading of the automatic adjustment clause statute is unreasonable.

11 **Q. DOES THE LANGUAGE OF ORS 757.259(2) REQUIRE THE USE OF**
12 **ACTUAL ACCOUNTING COSTS OR PROHIBIT THE USE OF COST**
13 **ESTIMATION OR APPROXIMATION?**

14 A. No. CUB seems to suggest that the phrase "identifiable utility expenses or
15 revenues" means "identifiable in the utility's accounting system." As I have
16 already indicated, it is often the case that utility costs and revenues are known
17 or identifiable only after estimation or approximation. CUB has misread the
18 deferred accounting statute.

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Response to ICNU's Arguments

Q. ICNU CRITICIZES THE SD-PCAM BECAUSE IT WOULD ALLOW DEFERRAL OF COSTS UNRELATED TO THE 2005 HYDRO CONDITIONS. PLEASE SUMMARIZE ICNU'S ARGUMENTS.

A. ICNU argues that: (1) PGE's deferral applications requested permission to defer specific costs related to the 2005 hydro shortfall; (2) the Commission cannot allow deferral of costs unrelated to a company's request without engaging in retroactive ratemaking; (3) the SD-PCAM would allow deferral of costs unrelated to the 2005 hydro conditions; and (4) therefore, the Commission cannot authorize the use of the SD-PCAM for 2005 because it would constitute retroactive ratemaking. (ICNU/300, Falkenberg/5-14.)

Q. ARE ICNU'S RETROACTIVE RATEMAKING ARGUMENTS WELL FOUNDED?

A. No. First, as I have already indicated, the identification of hydro-related costs is a matter of estimation and approximation. Contrary to ICNU's assertions, regional power prices are related to regional hydro conditions. Whether PGE replaces a hydro generation shortfall with market power purchases, increased generation from its natural gas fired plants, or a mix of each, depends on the prevailing spread between regional electricity and natural gas prices. The SD-PCAM strikes a reasonable balance between capturing hydro-related costs and excluding other costs.

Second, ICNU's argument is based on the false premise that the Commission cannot allow deferral of costs that are not specifically identified in

1 the utility's request. The Commission has the discretion to condition a utility's
2 deferral request by requiring the utility to defer other costs or revenues to
3 create a deferral that appropriately matches costs borne by and benefits
4 received by ratepayers.

5 **Q. ICNU ASSERTS THAT PGE'S 2005 HYDRO REPLACEMENT COSTS ARE**
6 **UNRELATED TO REGIONAL POWER PRICES AND REGIONAL NATURAL**
7 **GAS PRICES. (ICNU/300, FALKENBERG/11-12.) DO YOU AGREE WITH**
8 **THESE CLAIMS?**

9 A. No. PGE's 2005 hydro replacement costs are directly related to prevailing
10 electricity and natural gas prices. Whether PGE replaces the 2005 hydro
11 generation shortfall with market power purchases, increased generation from
12 its natural gas fired plants, or a mix of each, depends on the prevailing spread
13 between regional electricity and natural gas prices. If the spread between
14 regional electricity and natural gas prices increases to a level where it is
15 economic to dispatch the Beaver plant, then the variable cost of this added
16 generation is a direct hydro replacement cost. If the spread between regional
17 electricity and natural gas prices does not increase to a level where it is
18 economic to dispatch the Beaver plant, then the cost of a spot market power
19 purchase is a direct hydro replacement cost. ICNU mistakenly argues that
20 PGE's 2005 hydro replacement costs are unrelated to changes in wholesale
21 electricity and natural gas prices.

22 **Q. ICNU ASSERTS THAT THERE IS NO EVIDENCE THAT REGIONAL HYDRO**
23 **CONDITIONS HAVE ANY MEASURED IMPACT ON REGIONAL POWER**

1 Mr. Falkenberg proceeded to explain that it is difficult to determine the
2 expected cost of replacement energy:

3 One serious problem with properly designing such a hedge is
4 that it is necessary to have a good approximation of the
5 relationship between hydro generation and market prices.
6 Without such information, it would be very difficult to design a
7 truly revenue-neutral hedge. Thus, the lack of appropriate
8 modeling seriously handicaps this approach at the present time.
9 (ICNU/100, Falkenberg/30, Lines 15-19.)

10 **Q. ICNU CLAIMS THAT ITS HYDRO HEDGE IS A VIABLE OPTION FOR THE**
11 **COMMISSION IN THIS CASE. (ICNU/300, FALKENBERG/4, LINES 24-28.)**
12 **DO YOU AGREE WITH THIS ASSESSMENT?**

13 A. No. ICNU's hydro hedge is not a viable option because Mr. Falkenberg failed
14 to complete the design of the hydro hedge. In fact, Mr. Falkenberg argues that
15 the hydro hedge cannot be completed until there is a good approximation of
16 the relationship between hydro generation and market prices. However, given
17 his later opinion that there is nothing to suggest that regional power prices or
18 regional natural gas prices are impacted in any meaningful way by regional
19 hydro conditions, it seems odd that Mr. Falkenberg could not complete the
20 hydro hedge. Either there is a relationship between hydro generation and
21 market prices and a good approximation is needed to complete the hydro
22 hedge, or no such relationship exists and there is no barrier to completing the
23 hydro hedge.

24 **Q. HOW SHOULD THE COMMISSION RESPOND TO ICNU'S TESTIMONY ON**
25 **THIS POINT?**

1 A. ICNU's testimony on the relationship between regional hydro conditions and
2 regional power prices is unreliable. The Commission should: (1) acknowledge
3 the Council's work on this issue and find that there is a relationship between
4 regional hydro conditions and regional power prices; (2) recognize that the cost
5 of poor hydro conditions is not readily identifiable in PGE's accounting system
6 and is known only after estimation and approximation; and (3) recognize that in
7 exercising its discretion to approve deferred accounting of hydro-related
8 replacement power costs it must choose an approximation that reasonably
9 balances the inclusion of hydro-related costs against the exclusion of other
10 unrelated costs.

11 **Q. HAS ICNU PROPOSED A DEFERRAL TEST THAT THE COMMISSION CAN**
12 **USE TO EVALUATE DIFFERENT METHODS OF SEPARATING HYDRO-**
13 **RELATED COSTS FROM UNRELATED COSTS?**

14 A. Yes. ICNU states:

15 While it may not be possible to enumerate all of the methods the
16 Commission might consider, one element must be common to
17 all reasonable methods: *if there is no hydro generation variation*
18 *between actual and forecast, whatever method used should*
19 *result in zero deferred costs.* This is an acid test that
20 distinguishes between an allowable method and one that is not
21 allowable for any mechanism that the Commission intends to
22 implement retroactively to January 1, 2005. (ICNU/300,
23 Falkenberg/11, Lines 9-15, emphasis in original.)

24 **Q. IS ICNU'S DEFERRAL TEST FOR SEPARATING COSTS RELATED TO THE**
25 **2005 HYDRO SHORTFALL FROM THOSE UNRELATED TO THE 2005**
26 **HYDRO SHORTFALL REASONABLE?**

1 A. No. The Commission should not grade alternative methodologies solely on
2 how well they capture hydro-related costs given normal streamflow conditions.
3 The Commission has already indicated in Order 04-108 that it will not approve
4 deferred accounting for hydro-related replacement power costs unless the
5 hydro conditions are extraordinary and the financial impact is substantial.
6 ICNU's deferral test (i.e., no hydro generation variation must result in zero
7 replacement power costs) is too narrowly focused on normal conditions. The
8 Commission should also grade alternative methodologies on how well they
9 identify hydro-related costs given extreme streamflow conditions. For PGE,
10 doing well given extremely poor hydro conditions means capturing the price
11 hedge associated with the dispatch of its normally unused natural gas-fired
12 generation. The SD-PCAM will capture any re-dispatch of the Beaver and
13 Coyote Springs natural gas-fired generation plants and PGE's capacity tolling
14 agreements. In doing so, however, the SD-PCAM will not necessarily produce
15 a zero result under normal hydro conditions. The SD-PCAM would likely fail
16 ICNU's deferral test. The Commission should recognize, however, that ICNU
17 inappropriately grades deferral methodologies solely on how well they perform
18 under normal hydro conditions.

19 **Q. DO YOU AGREE WITH THE SECOND UNDERPINNING OF ICNU'S**
20 **RETROACTIVE RATEMAKING ARGUMENT, WHICH IS THAT THE**
21 **COMMISSION CANNOT ALLOW DEFERRAL OF COSTS THAT ARE**
22 **UNRELATED TO THE COSTS IDENTIFIED IN PGE'S DEFERRAL**
23 **APPLICATION?**

1 A. No. However, as discussed above, I do not think it is necessary for the
2 Commission to consider this second prong of ICNU's argument because the
3 costs that may be deferred under the SD-PCAM are not unrelated to the costs
4 of hydro variation. Even assuming the Commission does address this
5 argument, ICNU is incorrect.

6 **Q. PLEASE EXPLAIN.**

7 A. ICNU offers no authority or citation for its assertion that the Commission cannot
8 allow deferral of cost unrelated to hydro variations without engaging in
9 retroactive ratemaking. In fact, no such limitation is found in ORS 757.259.
10 ORS 757.259 authorizes the Commission to include in rates costs that the
11 Commission finds should be deferred to match appropriately the costs borne
12 and benefits received by ratepayers. Under this broad authority, the
13 Commission may require a utility to defer costs that are not specifically
14 identified in the utility's deferral application and in fact are unrelated to the
15 identified costs, but that should be deferred in connection with those identified
16 in the application to result in an overall deferral that appropriately matches the
17 costs and benefits received by ratepayers.

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Conclusion

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**Q. IN PREVIOUS TESTIMONY IN THESE CASES YOU INDICATED THAT THE
SD-PCAM STRIKES A REASONABLE BALANCE BETWEEN TRACKING A
NARROW SUBSET OF NVPC AND CAPTURING THE BROAD
INTERACTIONS THAT OCCUR WHEN PGE ADJUSTS ITS SUPPLY**

1 **PORTFOLIO TO CHANGING HYDRO CONDITIONS. HAS THE CUB OR**
2 **ICNU SURREBUTTAL TESTIMONY CHANGED YOUR OPINION ON THIS**
3 **MATTER?**

4 A. No. First, contrary to CUB's arguments, it is not unreasonable to exclude
5 variation in customer load and the impact of PGE's post RVM advanced power
6 purchasing from the SD-PCAM. Second, contrary to ICNU's arguments, it is
7 reasonable to include the impact of variation in regional electricity and natural
8 gas prices in the SD-PCAM. The SD-PCAM explicitly recognizes that for PGE
9 the cost of replacing lost hydro generation is tied to the economic dispatch of
10 its Beaver generation units and capacity tolling agreements. The SD-PCAM
11 accurately tracks the dispatch of these resources. At the same time, however,
12 it does not track other costs associated with deviations in load or advance
13 power purchasing. The SD-PCAM achieves a reasonable balance between
14 tracking too narrow of a subset of NVPC and tracking all of the components of
15 NVPC.

16 **Q. DOES THIS CONCLUDE YOUR TESTIMONY?**

17 A. Yes.

CERTIFICATE OF SERVICE

U E 165/U M 1187

I certify that I have this day served the foregoing document upon all parties of record in this proceeding by delivering a copy in person or by mailing a copy properly addressed with first class postage prepaid, or by electronic mail pursuant to OAR 860-13-0070, to all parties or attorneys of parties.

Dated at Salem, Oregon, this 21st day of July, 2005.



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UE 165
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UM 1187
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