ORDER NO. 01-988

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BEFORE THE PUBLIC UTILITY COMMISSION

OF OREGON

UE 115

In the Matter of Portland General Electric Company's Proposal to Restructure and Reprice Its Services in Accordance with the Provisions of SB 1149.	))))	ORDER

DISPOSITION: APPLICATION FOR RECONSIDERATION DENIED; MOTION TO REOPEN THE RECORD DENIED.

In this order, the Commission denies a request by a coalition of customer groups to reconsider new rates approved for Portland General Electric in Order No. 01-777. The Industrial Customers of Northwest Utilities (ICNU), the Citizens' Utility Board (CUB), and the Associated Oregon Industries (AOI) (collectively referred to as the Joint Parties) sought reconsideration of the new rates due to rate shock.[1] Portland General Electric (PGE or the company) and the Commission Staff (Staff) opposed the request.

Our decision in Order No. 01-777 completed a nearly year-long review of a request by PGE to restructure and reprice its services to comply with Senate Bill 1149, an electric restructuring act passed by the 1999 Legislative Assembly. Due primarily to significantly higher power and fuel costs, we approved new schedules that increased PGE's overall rates by approximately 38 percent. Other adjustments to PGE's rates not related to this docket increased overall rates to 41.5 percent, effective October 1, 2001.

In their request for reconsideration, the Joint Parties present many arguments in an attempt to mitigate the rate increase. We share the Joint Parties' concerns that the rate increase will severely impact customers and further burden the local economy and wish that the increase was not necessary. As noted above, however, the rate hike was primarily due to the increased cost of power in the marketplace. Wholesale power costs for PGE have increased some 173 percent since the company's last general rate change in 1997. Thus, we affirm our prior decision that the new rates are fair, just, and reasonable, and that the increase is necessary for PGE to maintain financial viability and the capability to fulfill its obligation to serve its customers.

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[1] Subsequently, the Joint Parties filed a motion to reopen the record for purposes of including the comments received at an October 18, 2001 Public Meeting in Portland. We scheduled that meeting to hear public comments on the recent price increases for both electricity and natural gas in Oregon. The purpose of the meeting was not to take testimony in this docket. Given our conclusion that the Joint Parties have failed to establish that any grounds exist for reconsideration of Order No. 01-777, we need not address their subsequent motion to reopen the record. The motion to reopen the record is denied.

Background

To better address the Joint Parties' arguments, we begin with a review of this docket and Order No. 01-777. Like other rate cases, this proceeding began with an application to revise tariff schedules. The events preceding PGE's October 2000 application, however, made clear that this case would not be a typical rate investigation. In 1999, the Legislative Assembly passed Senate Bill 1149, an electric restructuring act. To implement the new law, PGE was required to restructure and reprice its services to give its customers the option of purchasing electricity from other providers. In 2000, the western wholesale power markets began to exhibit unprecedented prices and price volatility. As a result, PGE incurred significant and unanticipated expenses for the power supply necessary to meet the needs of its retail customers. Early in the proceeding, PGE estimated that rising fuel and power costs would require a rate increase of 60 percent for large nonresidential customers and 45 percent for small nonresidential customers.

As the investigation progressed, the parties focused on three primary issues: (1) non-power O&M (Operating & Maintenance) costs; (2) power costs; and (3) return on equity (ROE). PGE, Fred Meyer Stores, and Staff entered a stipulation on the first issue—non-power O&M costs. The stipulation reduced PGE's rate base by $135.6 million and operating expenses by $40.6 million and increased other revenue by $1.7 million. CUB and ICNU were not parties to the stipulation and argued that the stipulated expenses for PGE's non-power O&M costs were excessive and should be further reduced. In addition to $26.5 million of adjustments from the stipulation, CUB recommended other non-power O&M cost reductions totaling $28.5 million. ICNU proposed an additional $13.4 million in non-power O&M reductions.

Unlike the first issue, ICNU and CUB joined PGE, Fred Meyer, and Staff in settlement on the second issue—power costs. The stipulation, signed by all five parties, noted PGE's exposure to the uncertain and volatile wholesale energy market. Given the unique circumstances, the stipulation included a Power Cost Adjustment (PCA) mechanism to allow PGE to adjust rates to account for changes in power costs. The mechanism tracks the fluctuations in power costs and adjusts rates accordingly.

The parties were unable to reach settlement on the third issue—return on equity (ROE). PGE and Staff presented cost of equity testimony from several expert witnesses. Relying primarily on a Discounted Cash Flow (DCF) analysis, PGE estimated its required ROE to be 11.5 percent. Staff argued that PGE's request was excessive. Relying on the DCF model and a Capital Asset Pricing Model (CAPM) analysis, Staff recommended the adoption of a ROE of 9.0 percent. ICNU, CUB, and AOI presented no expert testimony on this issue.

After hearings, briefing, and closing arguments, the parties submitted these three issues and other matters to us for resolution. As we explained in Order No. 01-777, this Commission discharges its ratemaking function in two steps. First, we determine the utility's reasonable costs of providing service and expected revenues, so that we can set utility rates at just and reasonable levels. To determine a utility's revenue requirement, we examine its gross revenues, operating costs, such as wages, fuel, and maintenance, as well as annual charges for depreciation and operating taxes. We also review the utility's investment in plant and

equipment—*i.e.*, rate base—and determine a fair rate of return on that investment. Second, we allocate that revenue requirement among customer classes and services. In this phase, we distribute the burden of meeting those revenue requirements fairly among different classes of ratepayers, such as residential and industrial customers.

Based on our review of the evidence in the record, we addressed the parties' arguments and made detailed decisions about what costs should be included in PGE's revenue requirement. With regard to the first primary issue—non-power O&M costs—we adopted several of CUB's and ICNU's proposals and, furthermore, imposed additional reductions to help offset rising power costs. We did not adopt all of CUB's and ICNU's proposed reductions, because we determined that the parties had double counted some costs by targeting the same expenses in separate adjustments, and targeted other expenses that were already reduced by the revenue requirement stipulation filed by PGE and Staff. We also concluded that other challenged expenses were related to PGE's obligation to implement Senate Bill 1149, and that the postponing of certain programs might actually increase costs over time. After our analysis, we adopted the $26.5 million of adjustments from the stipulation, and reduced PGE's non-power O&M costs by an additional $7 million.

We found the parties' proposed settlement of the second issue—power costs—to be reasonable, and we adopted it. We explained how the PCA mechanism will allow PGE to account for variations between expected power costs included in base rates and the actual power costs incurred, and how it will lower rates if the company's power costs decline. We agreed with PGE, ICNU, CUB, Fred Meyer, and Staff that the PCA mechanism properly balances the interests of customers and PGE, and helps ensure the company's continued ability to secure a reliable source of energy to meet customer demand.

To resolve the third issue—ROE—we modified the parties' proposals and adopted a 10.5 percent ROE, which included a 25 basis point downward adjustment for reduced risk due to PGE's above average equity ratio. In doing so, we gave no weight to the Staff's CAPM estimates. Although this Commission has relied on the CAPM as an appropriate method for estimating a utility's cost of common equity for over 20 years, we concluded that the financial model did not provide supportable and reasonable results in this docket. We were particularly troubled by the fact that CAPM analyses appeared to be producing results below PGE's cost of new, long-term debt.

Based on these decisions and others made in the docket, we ultimately approved new rate schedules for PGE that increased overall rates by approximately 38 percent.[2] Under the rate spread adopted for the new schedules, residential rates increased about 26 percent, while industrial rates increased about 46 percent. The authorized increase, aside from power cost issues, was almost $50 million less than PGE had originally requested.

[2] Three other adjustments to PGE's rates—not related to this docket—actually increased overall rates to 41.5 percent, effective October 1, 2001. These additional increases were caused by an adjustment to PGE's energy conservation program called SAVE (Share all Value Equitably), the expiration of a Trojan credit, and an increase to the Low-Income Assistance program.

Request for Reconsideration

The Joint Parties now seek reconsideration of Order No. 01-777 pursuant to ORS 756.561. The Commission may grant reconsideration "if sufficient reason therefor is made to appear." OAR 860-014-0095(3) provides that the Commission may grant an application for reconsideration if the application establishes:

> (a) New evidence which is essential to the decision and which was unavailable and not reasonably discoverable before issuance of the order;
>
> (b) A change in the law or agency policy since the date the order was issued, relating to a matter essential to the decision;
>
> (c) An error of law or fact in the order which is essential to the decision; or
>
> (d) Good cause for further examination of a matter essential to the decision.

The Joint Parties do not question any decision made in Order No. 01-777. Nor do they expressly challenge the prudence of any PGE expenditure, including the company's power and fuel costs. Instead, the Joint Parties contend that we should reconsider the order (1) to review whether PGE's rates are fair, just, and reasonable in light of the rate shock impact on customers, (2) to review new evidence regarding the deteriorating Oregon economy and how it will exacerbate the rate shock caused by PGE's rates, and (3) to adopt measures to mitigate the rate impact. We address each argument separately.

Rate Shock

The Joint Parties allege that Order No. 01-777 contains an error of law because the Commission failed to eliminate or mitigate the rate shock caused by PGE's rates. The Joint Parties contend that "regardless of the prudency of the utility's expenditures, rate increases that cause rate shock are not just and reasonable."[3] Therefore, the Joint Parties argue that the Commission should grant reconsideration to remedy the rate shock by denying PGE the full recovery of its revenue requirement.

The Joint Parties' argument is based on a belief that this Commission may consider the impact of rate shock when establishing a utility's revenue requirement. In essence, the Joint Parties claim that, in addition to examining the utility's costs, the Commission must also consider the interests of captive customers and the relevant economic conditions. If the Commission determines that the utility's recovery of its increased costs would cause rate shock, the Joint Parties believe that the Commission should reduce the revenue requirement to mitigate the rate increase—even if that requires eliminating prudent and essential operating expenses. To support

[3] Joint Parties' Application for Reconsideration at 5.

their claim, the Joint Parties cite several cases that purportedly demonstrate the willingness of other commissions to reduce a utility's revenue requirement based on rate shock concerns.

This Commission has broad authority to supervise and regulate every public utility and has a duty to represent the customers of any public utility and the public in general in all controversies regarding rates.[4] In exercising this authority, we carefully review a utility's costs to ensure that rates charged to customers are fair, just, and reasonable. We also consider the impact of rate increases on customers when setting new rates.[5] The law does not permit us, however, to use rate shock as a tool to authorize a revenue requirement that is unreasonably low. Rates must be sufficient for the utility to maintain financial viability and the capability to fulfill its obligation to provide electricity to customers in its service territory. Accordingly, this Commission must allow a utility the opportunity to recover increased operating expenses that are prudently incurred. We cannot ignore the importance to ratepayers of maintaining the financial viability of the utility.

Contrary to the Joint Parties' assertions, this Commission has not previously used rate shock to reject prudently incurred expenses. "Rate shock" is not a legal principle; rather, it is a factor the Commission has considered in the rate spread and rate design stage of various rate proceedings. When allocating a utility's revenue requirement among customer classes, the Commission has pursued—where possible—a policy of gradualism by avoiding substantial rate increases for any particular customer class. For example, in *Re Pacific Northwest Bell*, Order No. 90-920, the Commission had to allocate a telephone company's revenue requirement between non-basic services, such as long distance, and basic services. Because non-basic services were traditionally priced above cost in order to subsidize basic services, the Commission was concerned that an abrupt change toward cost-based pricing would cause rate shock to customers of basic service. Accordingly, the Commission designed rates to minimize this potential impact. The Commission did not, however, use rate shock to reduce the telephone company's revenue requirement. As PGE notes, the Commission expressly stated, "having determined the total amount the utility should be allowed to earn from its Oregon intrastate operations, rates must be designed to generate that level of revenues from the various services provided by the company."[6]

The Joint Parties' reliance on the cases from other jurisdictions is misplaced. In *Nezperce Roller Mills*, 1 PUR NS 46 (Idaho P.U.C. 1933), the Idaho Commission rejected a petition of grain elevator operators to increase rates. In reaching its decision, the Idaho Commission noted the farmers' inability to pay higher charges for the handling and storage of grain given the present deplorable conditions caused by the Great Depression. In doing so, however, the Idaho Commission explicitly abandoned its statutory ratemaking guidelines,

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[4] *See* ORS 756.040; *Simpson v. Phone Directories Co*., 82 Or App 582 (1986).

[5] *See, e.g.,* Order No. 01-777, 4-6, 7-16, and 37-38.

[6] *In the Matter of the Investigation into the Revenue Requirements and Rate Structure of Pacific Northwest Bell Telephone Company, d.b.a. U S WEST Communications, Inc.,* Order No. 90-920 at 2. *See also, Publishers Paper Company v. Davis*, 28 Or App 189, 197 (1977) (Approved rate structure required a 5.6 percent increase for residential customers, a 4.1 percent increase for commercial customers, and a 52.6 percent increase for large industrial customers).

concluding: "[O]ur answer to this lamentable situation is that where man-made laws part company with justice, this commission prefers to pursue the path of justice and predicate its decision thereon."[7] Because we cannot abandon our statutory responsibilities, we find the *Nezperce* decision to be of questionable relevance. Moreover, the Idaho Commission noted that the grain elevator operators apparently sought the rate increase not to recover increased costs, but rather to benefit from the anticipated increase in crop prices.

The Joint Parties also cite *In Re Avista Corporation*, where the Washington Utilities and Transportation Commission (WUTC) reduced a utility's rate request due, in part, to rate shock concerns. There, a utility sought an immediate 37 percent surcharge to recover escalating power costs. The WUTC noted the unique circumstances underlying the request and indicated that it was required to help the utility meet the current financial crisis while protecting its customers, to the extent possible, from rate shock. The WUTC eventually approved a 25 percent increase—the minimum amount the commission found necessary for the utility to preserve its ability to fulfill its service obligation to the public. In granting the increase, however, the WUTC emphasized that its preliminary decision did not address whether the power costs were prudently incurred:

> We make no ultimate judgment in today's action about the appropriateness or prudence of management decisions made by the company to respond to this extraordinary situation. The company remains responsible for proving the costs it has incurred are appropriate and prudent. The rates we order today are subject to refund, should the company fail to carry this burden in the context of a full examination of the company's management decisions and costs.[8]

Consequently, the WUTC did not use rate shock to reduce the utility's recovery of prudently incurred expenses or otherwise reduce its revenue requirement, as the Joint Parties seek here. Rather, it allowed the utility to implement a preliminary rate increase to cover rising power costs subject to a full examination of whether the increased costs were prudently incurred.

The numerous other cases cited by the Joint Parties are similarly unpersuasive. Many of them confirm that rate shock is one factor to be weighed when a regulatory commission is designing rates. Others simply verify a commission's obligation to consider the effect of proposed rate increases on the ratepayers, as we did in this docket. Many cited cases support our conclusion that PGE is allowed the opportunity to recover its prudently incurred costs and a reasonable return for its shareholders.

We conclude that the Joint Parties' rate shock argument has no basis in law. Rate shock is a relevant factor in the rate design stage of the case; it plays no role in determining a utility's revenue requirement. Accordingly, the argument provides no support for reconsideration of Order No. 01-777.

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[7] 1 PUR NS at 48.

[8] *Re Avista*, Docket No. UE-010395, Sixth Supp. Order at 3.

New Evidence Essential to the Decision

The Joint Parties contend that there is new evidence about the declining state and national economy that was unavailable to the Commission when it made its decision. They present an Oregon Employment Department Press Release and newspaper articles from *The Wall Street Journal* and the *Oregonian,* which provide information about rising unemployment levels and an impending recession. The Joint Parties speculate that, given the poor state of the economy, some of PGE's costs, such as labor, may have been reduced. They also argue that the Commission should reevaluate PGE's costs of capital given the recent reductions in interest rates.

While the proffered evidence shows a continuing economic decline, the Joint Parties fail to establish how these changes materially affect our decision. As PGE notes, the national and regional economy has been declining since the beginning of 2001, if not earlier. While that trend has unfortunately continued since we issued Order No. 01-777, the Joint Parties fail to provide any evidence to show that the changes in these economic indicators are significant enough to change the outcome in this docket. The reported economic indicators are not substantially different than those that existed at the time we issued our order.

We also find the Joint Parties' argument relating to falling interest rates unpersuasive. Although the CAPM relies on interest rates to set a risk-free rate in estimating cost of equity, we found that the financial model did not provide supportable and reasonable results for use in this docket.[9] Accordingly, we declined to use CAPM and, instead, relied on the DCF model to establish a reasonable ROE. The Joint Parties do not criticize our decision to reject CAPM in this docket. Nor do they provide evidence that the continued decline in interest rates materially affects our analysis based on the DCF model, which does not directly rely on interest rates to estimate cost of equity.

Accordingly, we conclude that the Joint Parties have failed to show new evidence that is essential to the decision and that was unavailable and not reasonably discoverable before issuance of the order.

Good Cause for Further Examination

Given the magnitude of the rate increase and the declining economy, the Joint Parties also contend that good cause exists for the Commission to reconsider whether ratepayers can withstand such a large increase at this time. The Joint Parties propose that the Commission limit the total rate impact on customers by: (1) phasing in the rate increase; (2) decreasing utility expenditures; (3) requiring the utility to propose a rate mitigation plan; or (4) reducing utility earnings.

It is unclear whether this Commission has the authority to require a phase-in of the rate increase. Unfortunately, the Joint Parties offer no specific phase-in proposal, and do not

[9] *See* Order No. 01-777 at 32.

explain how such a phase-in would allow the Commission to follow statutory and constitutional requirements to keep the utility financially healthy. ORS 757.259 allows this Commission to authorize the deferral of certain expenses for later incorporation in rates. We have previously construed that statute narrowly, and limited its application to the recovery of discrete expenses that might affect a utility's earnings on a short-term basis.[10] The statute cannot be used to authorize the deferral of general expenditures that a utility incurs in an ongoing and continuous manner.

Even if this Commission had the authority to order a phase-in of PGE's rate increase, such a remedy raises a number of problems. We agree with Staff that a phase-in would not match costs and benefits, as costs deferred and recovered later could fall on different customers and usage levels. In addition, the Joint Parties' proposed deferral would simply prolong the rate increase over a longer period of time, and might require the charging of higher rates in the future than those authorized in Order No. 01-777. PGE has contracted for most of its power needs through 2002, and lower wholesale prices will not have much effect on rates before 2003. Furthermore, since January 1, 2001, PGE has already deferred as much as $100 million in excess net power costs, for which the company will seek recovery.[11]

The Commission has already addressed the Joint Parties' second proposal—decreasing PGE's expenditures. As noted above, we carefully reviewed CUB and ICNU proposed reductions to PGE's non-power O&M costs.[12] After our analysis, we adopted several of CUB's and ICNU's recommendations and reduced PGE's O&M costs by an additional $7 million. In their request for reconsideration, the Joint Parties do not challenge any of our conclusions on this matter. Nor have they established how the Commission could further reduce PGE's expenditures to eliminate their concerns about rate shock. As Staff notes, even if we had agreed with all of CUB's and ICNU's proposed adjustments to PGE's non-power O&M costs—and we do not—the overall percentage rate increase would have been reduced from 41.5 to 35.7 percent.[13] While this would help mitigate the rate impact, it would not eliminate the concerns raised by the Joint Parties.

With regard to the remaining proposals, the Joint Parties have failed to show that this Commission has a statutory basis to order a rate mitigation plan or to simply reduce PGE's earnings. As we explained in the challenged order, this Commission must set rates high enough for PGE to collect "enough revenue not only for operating expenses but also for the capital cost of business."[14] If adopted, the Joint Parties' proposals could violate PGE's right to recover these revenues.

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[10] *See, In Re PacifiCorp*, Order No. 92-1128 at 8.

[11] *See* Dockets UM 1008/1009.

[12] Order No. 01-777 at 7-17.

[13] These figures include the rate increase approved in UE 115, plus the additional adjustments taking effect October 1, 2001. *See* footnote 1, *supra*. Staff's calculation used the entire $55 million claimed as CUB's non-power O&M adjustment, even though that figure double-counts some of the stipulated adjustments accepted by the Commission.

[14] *See* Order No. 01-777 at 23, citing *FPC v. Hope Natural Gas Co.*, 320 US 591 (1944).

For these reasons, we conclude that the Joint Parties have failed to establish that good cause exists for further examination of a matter essential to the decision.

CONCLUSION

We conclude that the Joint Parties have failed to establish any grounds for reconsideration under OAR 860-014-0095(3). They present no new evidence, error of law, or establish good cause to justify reconsideration of our decision. Accordingly, the request for reconsideration should be denied.

ORDER

IT IS ORDERED that the application for reconsideration of Order No. 01-777, jointly filed by the Industrial Customers of Northwest Utilities, the Citizens' Utility Board, and the Associated Oregon Industries, is denied.

Made, entered, and effective _____.

_____
Roy Hemmingway
Chairman

_____
Lee Beyer
Commissioner

_____
Joan H. Smith
Commissioner

A party may appeal this order to a court pursuant to ORS 756.580.