ORDER NO. 07-454

ENTERED 10/22/07

BEFORE THE PUBLIC UTILITY COMMISSION

OF OREGON

UE 180/UE 184

In the Matters of PORTLAND GENERAL ELECTRIC COMPANY Request for a General Rate Revision (UE 180); Request for a General Rate Revision relating to the Port Westward Plant (UE 184).	)))))))))	ORDER

DISPOSITION: ADVICE NO. 07-15 ALLOWED TO GO INTO EFFECT ON A PERMANENT BASIS

INTRODUCTION

On June 14, 2007, the Public Utility Commission of Oregon (Commission) allowed Portland General Electric Company (PGE) to include, in rates, costs associated with its Port Westward generating facility. *See* Order No. 07-273. We had previously reviewed and approved the plant's costs in a general rate proceeding concluding on January 12, 2007. *See* Order No. 07-015. Due to the delay in the plant's operational date, we implemented the rates subject to refund and subject to a 15-day review period, for Staff and any intervenors, to establish whether good cause exists for a reexamination of PGE's costs in rates. Specifically, we held:

> [S]taff and intervenors have until the close of business on June 26, 2007, to submit a motion seeking a reopening of this docket for the reexamine of PGE's costs in light of changes since Order No. 07-015 was issued. The motion need not include an evidentiary showing, but should identify specific costs that have changed from test year expenses and include an estimate of the cost impact. PGE and other parties will have until July 11, 2007 to file a reply to any motion. If Staff or an intervenor can establish that good cause exists for a reexamination of PGE's test year expenses, we will reopen this docket and conduct further proceeding to allow a thorough and complete review of PGE's expenses and, if warranted, adjust rates accordingly.

Order No. 07-273 at 5.

Both the Citizens' Utility Board of Oregon (CUB) and the Commission Staff (Staff) timely filed motions. CUB seeks a reexamination of PGE's rates, alleging that the company's actual costs and revenues have significantly deviated from those forecast in the general rate proceeding. Staff seeks an order allowing the Port Westward rates to go into effect permanently. Staff concludes that no further examination of rates for the Port Westward facility is necessary.

PGE opposes CUB's motion, but supports Staff's. PGE contends there is no showing that PGE's costs have significantly changed from the test-year forecast adopted in Order No. 07-015.

DISCUSSION

CUB, Staff and PGE each used different methodologies to evaluate whether the rates we approved in Order No. 07-015 are still reasonable in light of any cost changes that occurred during, or because of, the Port Westward delay. This included the identification of discrete changes to PGE's costs and revenues, as well as an overall review of the company's current financial performance. We address each party's methodology and arguments separately.

CUB

CUB identified three areas where PGE's costs and revenues have significantly deviated from the test-year forecast: (1) state tax rate; (2) Port Westward costs; and (3) increased revenues.

First, CUB notes that, since the rates were approved, the State of Oregon has lowered PGE's state income tax rate from 6.617 percent to 5.120 percent. CUB contends this reduction to tax expense, which is estimated to be approximately $2.8 million annually, is a real, identifiable reduction in PGE's costs that should be used to partially offset the Port Westward rate increase. Moreover, CUB places heightened emphasis on this proposed adjustment, pointing out that the legislature identified utility income taxes as one "of special interest to this state" when enacting Senate Bill 408. *See* ORS 757.267(1)(a). Thus, CUB concludes, the failure of the Commission to reduce PGE's rates by $2.8 million to reflect the company's current state tax rate would result in rates that are not fair, just and reasonable under ORS 757.210.

Second, CUB contends that Port Westward's actual impact on PGE's rate base was $3.2 million less than what was estimated in Order No. 07-015. CUB points to this overestimate of costs as another problem with PGE's decision to file its general rate case before Port Westward was completed. CUB argues that the Commission must update the company's rate base to prevent PGE from benefiting from its decision to make the early rate filing that necessitated the use of forecasted, rather than actual, results.

Third, CUB notes that PGE's actual income for the first four months of 2007 was significantly higher than estimates made in the rate case. According to CUB, the variation between PGE's actual results of operations and those costs forecasts for rates—due primarily to variable power costs—are so significant that the Commission should reexamine those forecasts to bring PGE's overall cost forecast up to date.

Staff

To determine whether the Commission should adjust rates, Staff examined PGE's overall revenue, fixed operating and maintenance (O&M) costs, depreciation and amortization, and state income taxes. Staff did not examine net variable power costs, reasoning that those costs will be trued-up via PGE's approved power costs adjustment mechanism (PCAM).

Staff first focused on Port Westward itself, and the original revenue requirement approved for plant costs in Order No. 07-015. While identifying the differences to rate base and state income taxes noted by CUB, Staff also determined that PGE's property taxes were higher for 2007 than anticipated because the company's property tax exemption was disallowed by Columbia County. Based on a review of overall costs, Staff finds that the delay of Port Westward caused only a slight reduction in overall revenue requirement—approximately $355,000 less than the original revenue requirement of $42 million.

Staff next reviewed changes to PGE's revenues and costs since Order No. 07-015. Because PGE's actual results of operations for the first four months of the year varied greatly from those forecast, Staff developed a proxy test year by combining the actual results for January through April with PGE's 2007 budget information for May through December. To annualize the results, Staff also adjusted the revenues of the actual results of operations by imputing 5/12 of the Port Westward revenue requirement impact into the first four months of the year.

Staff's analysis shows that PGE's projected revenues are lower than what was earlier forecast, while fixed O&M and Depreciation and Amortization are expected to be higher than test year expenses. Even with the offset of the lower state tax rate, Staff finds that these adjustments indicate a higher revenue requirement than established in Order No. 07-015.

Based on these findings, Staff concludes that PGE's current financial performance has not materially deviated from the test year period to warrant a reexamination of PGE's cost in rates for Port Westward. Accordingly, Staff recommends that the Commission allow the Port Westward rates to go into effect permanently.

Staff adds one caveat to its recommendation. Staff explains that PGE's power costs will be reviewed during the company's annual power cost update, and that the possibility exists that, during such review, Staff may discover that the Port Westward delay, in fact, impacts PGE's power costs. Due to that possibility, Staff recommends the Commission order that customers will be held harmless for any detrimental impact caused by the delay.

PGE

PGE's analysis compared the test year forecast with the company's projected earnings for 2007, which include actual results for January through April. PGE reports that the current projection of 2007 after-tax operating income, properly adjusted for out-of-period events and regulatory disallowances, is not significantly different than that used on the test-year forecast. Accordingly, PGE contends that the company's overall financial projections do not warrant a reopening of this docket.

PGE also contends that the delay in the on-line date did not significantly change the construction costs for the Port Westward plant. The fixed price construction contract, PGE explains, provided for liquidated damage payments if the plant was not completed by May 1, 2007. Although other costs, such as property tax, have changed from those assumed in the test year, PGE states that the cumulative effect of these changes would be to increase Port Westward's revenue requirement by over $2 million.

PGE raises numerous objections to CUB's motion to reexamine rates. First, it criticizes CUB for focusing on two cost elements that are less than projected to support its motion—state taxes and power costs—while ignoring other cost elements that are higher than projected. In addition to the higher Port Westward revenue requirement noted above, PGE states that its forecast 2007 O&M is higher than the test year forecast, with support O&M expected to be $8 million higher than the amount used to set rates in this docket.

Second, PGE contends CUB's analysis is misleading. CUB's reliance on four months of actual results is misplaced, PGE argues, because rates are based on average expected costs for an entire test year, not a four-month period that might reflect seasonality. In addition, PGE contends CUB erroneously compares pre-income tax figures and uses PGE's 2007 budget as representative of the test year projections. PGE claims that after-tax figures should be used, as they represent amounts left over after operating costs, to cover financing costs, and that the 2007 budget figures were not used by the Commission in establishing rates.

Third, PGE contends CUB places too much emphasis on power costs. PGE acknowledges that its power costs variations, to date, compare favorably to the test year projections. It emphasizes, however, that the Commission has already adopted the PCAM to review PGE's power costs variations. PGE notes that the Commission adopted the PCAM "to capture power cost variations that exceed those considered part of normal business risk[.]" Order No. 07-15 at 26. Thus, PGE concludes, it is not appropriate to address power cost at this time.

Finally, although it supports Staff's overall recommendation, PGE opposes Staff's proposal that the Commission hold ratepayers harmless from any subsequently discovered impact to power costs caused by the Port Westward delay. PGE notes that customers were not asked to pay the costs of Port Westward until the plant was providing service. PGE maintains that attempting to provide customers with speculative power cost benefits of a plant before that plant is operational and providing service to customers would not be fair or reasonable.

ANALYSIS

Due to the delay in Port Westward's operational date, we allowed PGE to implement rates incorporating the facility's costs on an interim basis. Before making those rates permanent, we wanted to provide our Staff and intervenors an opportunity to examine whether PGE's costs and revenues had sufficiently deviated from the forecasts earlier used to set rates. Specifically, we invited the parties to identify costs that have changed from test-year expenses and to include an estimate of the cost impact to warrant an adjustment to rates. *See* Order No. 07-273 at 5.

The process of examining whether to reevaluate and adjust PGE's rates is, fundamentally, an exercise of our ratemaking authority. This process will establish permanent rates for PGE, either at rates previously approved for the utility or as adjusted to account for changes to PGE's projected revenues or costs. Due to this fact, we must apply traditional ratemaking principles. We may not, as CUB appears to request, use profits of PGE during the first four months of 2007 to reduce future rates. *See Pacific N. W. Bell Telephone Co. v. Katz,* 116 Or App 302, 311 (1992). Moreover, we may not focus on one cost element while ignoring others. Because increases elsewhere may offset decreases, a change to one cost element does not, by itself, automatically require an adjustment to rates.

To properly examine whether an adjustment of rates established in Order No. 07-015 is necessary, we must examine PGE's current financial performance as if we were setting new rates. In other words, we must view costs and revenues holistically and in a manner consistent with establishing a test year for ratemaking purposes, by estimating future "normal" levels of operating costs and revenues. When using historic data, this requires removing abnormal events and amounts not expected to recur and including the effect of known changes in data that are expected to persist into the future, as well as making regulatory adjustments to recognize Commission orders and policies.

For these reasons, we find the methodology used by Staff most appropriate for this exercise. As discussed above, Staff developed a proxy test year by combining PGE's actual results for January to April with 2007 budget information for May to December. Staff chose to use budgeted amounts, rather than forecast, because they came closer to matching PGE's actual results for the first four months of the year. Staff also adjusted the results to annualize the impact of Port Westward revenue requirement impact into the first four months of the year.[1]

[1] We note one error in Staff's analysis regarding property taxes for Port Westward. The rates set in Order No. 07-015 included no recovery for Columbia County property taxes because of a county property tax exemption. In its analysis, Staff noted that the county disallowed the property tax exemption for 2007, and spread the loss of the 2007 property tax exemption over a five-year period because it represented a one-time event. As CUB points out, the fact that the loss of the exemption was a one-time event requires that it be simply removed from consideration, not spread out over a five-year period. This error, however, does not materially affect Staff's analysis or impact our decision.

Using this conservative approach, Staff's analysis indicates a slightly higher revenue requirement for PGE than that forecast in the test year to set rates. Based on this analysis, we conclude that, overall, there have been no significant deviations to PGE's expected costs and revenues to warrant a reopening of the record and adjustment of rates.

We are not persuaded by CUB that PGE's rates need to be adjusted to reflect changes in power costs, state taxes, and rate base. We acknowledge deviations to PGE's power costs from those used to set rates. However, power costs are, by their vary nature, subject to fluctuations—sometimes in favor of the utility, sometimes in favor of customers. To address these fluctuations, we traditionally normalize power costs when setting rates. Moreover, to address extreme power cost fluctuations, we have adopted the PCAM for PGE to adjust rates symmetrically in a manner to protect customers.

We must examine the source of the power cost deviations to determine whether a rate adjustment is warranted. Rate adjustments may be appropriate if the deviations reflect underlying structural changes to the power markets. No rate adjustments are required, however, to address deviations caused by other events, such as seasonal changes or non-recurring events. These more-typical causes will be captured by the PCAM.

Here, there is no evidence that the deviations to PGE's net variable power costs are the result of significant market changes. Accordingly, such cost changes are properly examined in PGE's annual PCAM proceeding, not here.

We have also adopted an automatic adjustment mechanism to address instances where a utility's income tax liability deviates from forecasted amounts. This mechanism, adopted pursuant to Senate Bill 408, will adjust rates, with interest, should the reduction of the state tax rate result in a lower income tax liability for PGE.[2] Moreover, as we have stated, a determination of whether rates are "fair, just and reasonable" must be based on a review of all revenues and costs rather than a single cost element. For these reasons, an adjustment to base rates is not required by law.

As to Port Westward's rate base, the fact that the plant's actual impact was less than what was estimated in Order No. 07-015 does not, in this case, warrant a reexamination of rates. We initially note that the $3.2 million reduction in rate base translates to an approximate $381,000 reduction in revenue requirement.[3] As discussed above, this revenue requirement reduction is offset by other cost increases. Moreover, ORS 757.355 governs the timing of when a utility may include property in rate base. The statute requires that the property be "presently used for providing utility service to the customer." Here, the Port Westward costs were not placed in service until the plant was providing utility service to ratepayers. Finally, all rate base components, to at least some degree, are typically estimates in a future test year. *See, e.g.*, Order No. 80-021 at 24 (when a future test year is

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[2] Even with the lower rates, we note that PGE's increased earnings the first four months of the year might actually increase the utility's tax liability.
[3] $3.2 million rate base amount multiplied by PGE's authorized return on equity (10.1%) and adjusted for tax related effects.

used, the data is drawn from budget figures and financial models of the utility). ORS 757.355 does not require the use of actual amounts or a true-up of forecasted amounts in establishing a rate base.

Accordingly, we conclude that the Port Westward rates, set forth in Advice No. 07-15, should be allowed to go into effect on a permanent basis. In reaching this decision, however, we reject Staff's proposed condition to hold customers harmless for any subsequently determined detrimental power cost impact resulting from the Port Westward delay. Through the operation of the PCAM, customers will receive power costs benefits, if any, from the delayed operational date of Port Westward. We agree with PGE that Staff's proposal, to also provide customers with speculative power cost benefits of Port Westward before the plant became operational, is neither fair nor reasonable. Furthermore, Staff's proposal fails to recognize potential benefits to customers resulting from the delay—notably the lack of carrying charges in rates during the interim period.

ORDER

IT IS ORDERED that Advice No. 07-15 is allowed to go into effect on a permanent basis.

Made, entered, and effective OCT 22 2007.

Lee Beyer
Chairman

John Savage
Commissioner

Ray Baum
Commissioner

A party may request rehearing or reconsideration of this order pursuant to ORS 756.561. A request for rehearing or reconsideration must be filed with the Commission within 60 days of the date of service of this order. The request must comply with the requirements in OAR 860-014-0095. A copy of any such request must also be served on each party to the proceeding as provided by OAR 860-013-0070(2). A party may appeal this order by filing a petition for review with the Court of Appeals in compliance with ORS 183.480-183.484.