

**BEFORE THE PUBLIC UTILITY COMMISSION  
OF THE STATE OF OREGON**

**UE-88 REMAND**

**PORTLAND GENERAL ELECTRIC COMPANY**

Rebuttal Testimony of

*Pamela G. Lesh  
Patrick G. Hager  
Jay Tinker  
Stephen Schue  
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**Portland General Electric**

**June 27, 2005**

**UE-88 REMAND / PGE / 6800  
LESH - HAGER**

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# **Policy & Recommendations**

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## I. Introduction

1 **Q. Please state your names and qualifications.**

2 A. My name is Pamela G. Lesh. I am PGE's Vice President of Regulatory Affairs and  
3 Strategic Planning. My qualifications are in Section V of PGE Exhibit 6000.

4 My name is Patrick G. Hager. My position is Manager, Regulatory Affairs. My  
5 qualifications are in Section IV of PGE Exhibit 6400.

6 **Q. What is the purpose of your testimony?**

7 A. We respond to policy and factual components of the testimony filed by Staff, Dan Meek and  
8 Jim Lazar. To the extent that any of their testimony makes legal arguments, we will respond  
9 in brief.<sup>1</sup>

10 **Q. How is your testimony organized?**

11 A. Our testimony is organized as follows:

12 In Sections II and III, we address the factual and policy positions Staff explains in Staff  
13 Exhibit 100, Busch-Johnson and Staff 200, Morgan, respectively. We note areas of  
14 agreement, and identify and discuss positions on which we disagree with Staff's views.

15 In Section IV, we address policy positions taken by URP in URP Exhibit 200, Lazar. In  
16 Sections V and VI, we address scope and policy positions taken by URP in URP Exhibit  
17 204, Meek.

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<sup>1</sup> For example, we do not address the issues raised in URP Exhibit 204 page 1 line 19 through page 8 line 16.

## II. Factual and Policy Issues in Staff Exhibits 100 and 200

1 **Q. Please outline this Section of your testimony.**

2 A. In this Section, we discuss areas of agreement and disagreement with factual and policy  
3 positions taken by Staff in Staff Exhibits 100 and 200. These include:

- 4 • Structure of analysis.
- 5 • Consideration of a range of possible outcomes.
- 6 • Treatment of steam generator replacement costs.
- 7 • Possible interpretation of Court of Appeals ruling to require exclusion only of return  
8 on equity.

9 **Q. With what factual and policy positions that Staff takes do you agree?**

10 A. We agree with Staff's overall policy position that: "the Commission intended that PGE  
11 should recover the value of customers' share of remaining Trojan investment in rates." Staff  
12 Exhibit 100, Busch-Johnson at 8, lines 20-22. Staff explains that to "argue in this remand  
13 proceeding that the Commission would have made a ratemaking decision in UE 88 that  
14 resulted in a significantly different recovery amount is inconsistent with the original  
15 decision." Staff Exhibit 100, Busch-Johnson at 7, lines 20-22. We appreciate Staff's  
16 acceptance and use of the basic structure of the analysis we presented. Staff Exhibit 100,  
17 Busch-Johnson at 10, lines 16-17.

18 We also generally agree with Staff's conclusion that the Commission "most likely  
19 would have allowed a moderate level of additional increase in rates with the intent of  
20 minimizing the amount of 'return on' PGE loses, and would have spread the rate impact  
21 over a number of years." Staff Exhibit 100, Busch-Johnson at 6, lines 16-18. While we  
22 agree with Staff that "there are numerous revenue requirement scenarios, with many

1 combinations of elements, which the Commission might have approved in UE 88,” however,  
2 we disagree that it is necessary for the Commission “to determine a ‘most likely’ scenario”  
3 (Staff Exhibit 100, Busch-Johnson at 12, lines 18-19) and “adopt one of the recommended  
4 approaches for PGE’s UE 88 revenue requirement.” Staff Exhibit 100, Busch-Johnson at  
5 26, lines 12-13. As a policy matter, PGE believes that the Commission can and should  
6 evaluate the reasonableness of the UM 989 settlement using a range of possible outcomes  
7 for the UE 88 remand.

8 **Q. Why do you believe that the Commission need not adopt a “most likely” UE 88 remand**  
9 **scenario in this phase of the proceedings?**

10 A. The Commission can evaluate whether its approval of the UM 989 settlement was within its  
11 authority and discretion by reference to a range of possible outcomes for UE 88. PGE  
12 believes such a range would demonstrate ample grounds upon which the Commission could  
13 find the settlement supportable. The Commission will need a point estimate of the UE 88  
14 rates, and subsequent years’ effects, only if the Commission decides that (a) the settlement  
15 was not within its authority and discretion, given the decision it has made with respect to the  
16 UE 88 remand, and (b) it has legal authority to calculate a refund for an amount by which  
17 the settlement exceeded that authority and discretion. In other words, as a policy matter, the  
18 point estimate should not drive the conclusion but should only assist in a calculation once  
19 the conclusion is reached.

20 We base this policy view on the inherently uncertain nature of determining now – over  
21 ten years later – what the Commission would have decided in UE 88. Likewise, we are  
22 hesitant now, to conclude that PGE would have stipulated to the same revenue requirement  
23 elements to which we stipulated in UE 88. For example, PGE stipulated in UE 88 to the

1 return on common equity of 11.6 percent. Had we known of the Court of Appeals ruling,  
2 we might not have agreed to this number. We might have refused to stipulate for less than a  
3 higher amount, say 11.8 percent. Staff might or might not have accepted that number and,  
4 had it not, the Commission might have chosen an ROE anywhere within the range of ROE  
5 estimates presented in the case. These are matters of some speculation at this point. It is to  
6 recognize the nature of this case as a remand and potential retroactive adjustment that we  
7 recommend that the Commission use all legitimate scenarios in evaluating the  
8 reasonableness of the UE 88 rates and the UM 989 settlement.

9 **Q. Are there any other Staff positions with which you agree?**

10 A. Yes. We generally agree with Staff's alternative to the second scenario we presented. Staff  
11 Exhibit 100, Busch-Johnson at 22, line 15 through 23, line 10. Staff's adjustment of this  
12 scenario to include a 12% rate increase in UE 88 but not a rate-smoothing power cost  
13 deferral is plausible and only somewhat inconsistent with the interests of intergenerational  
14 equity. As Staff notes, this scenario indicates no refund is due for UE 88 and leaves PGE's  
15 balance sheet in the same posture for evaluation of UM 989 as Staff's adjustments to PGE's  
16 second alternative. For the reasons we discussed above, we do not believe the Commission  
17 needs to adopt just one alternative to evaluate either UE 88 or UM 989.

18 **Q. With what policy or factual Staff positions does PGE disagree?**

19 A. We disagree with two Staff positions:

- 20 1. Staff's position that the Commission should exclude from the net benefits  
21 calculation any costs associated with the steam generator replacement Trojan would  
22 have required had it continued to operate.

- 1           2. Staff’s dismissal of PGE’s proposal that the Commission apply the Court of  
2           Appeals ruling to require excluding only return on common equity from rates, not  
3           the full cost of capital associated with the investment in Trojan.

4           We address each below.

5           **Q. Why do you disagree with Staff’s position on excluding the costs of the steam**  
6           **generators from the net benefits test?**

- 7           A. Staff provides two reasons in support of excluding this cost from the net benefits test. Staff  
8           suggests that: “it would be inconsistent for the Commission to find that it would not have  
9           allowed recovery of these costs in rates if the plant continued to operate, yet considered  
10          them as savings in the net benefits test in the closure scenario.” Staff also supports its policy  
11          position by noting its understanding that PGE did not seek legal redress from Westinghouse  
12          over the failure of the steam generators.

13           Staff’s first reason merely restates the Commission’s decision from UE 88. It does not  
14          rebut PGE’s policy position that the Commission might have exercised its discretion  
15          regarding the construct of the net benefits test and the hypothetical rate treatment of this  
16          future cost differently had it known of the Court of Appeals decision. As Staff’s testimony  
17          clarifies, excluding these costs from the continued operation scenario in the net benefits test  
18          was tantamount to a conclusion that, had PGE continued to operate the plant and invested in  
19          replacement steam generators, the Commission would have allowed none of those costs in  
20          rates. We think this unlikely. OPUC Order No. 95-322 explains only that the Commission  
21          found it “fair” that shareholders bear “some of the consequences” (OPUC Order at p. 3,  
22          emphasis added) of management investment decisions. A disallowance of the total cost  
23          would have been all, not some, and an extreme result.

1 Staff's second reason reflects a misunderstanding. PGE filed suit against  
2 Westinghouse in 1993 for breach of contract related to the Trojan steam generators.  
3 Replacement power costs were simply a measure of damages. The basis of the claim was  
4 the failure of the steam generators. As discussed in PGE's opening testimony, settlement of  
5 that litigation resulted in a credit to customers of about \$4 million. PGE Exhibit 6000, Lesh  
6 at 27, footnote 5.

7 **Q. Why do you disagree with Staff's position on PGE's proposal that the Commission**  
8 **interpret Court of Appeals ruling to require excluding only return on common equity**  
9 **from rates, not the full cost of capital associated with the investment in Trojan?**

10 A. We disagree because our view rests in regulatory policy and, perhaps, legal interpretation  
11 and Staff looks instead to a different basis. Staff supports its view with an "economics"  
12 perspective, noting that the return on equity is not really profit but is "simply a return of the  
13 'cost' of monies from equity holders." Staff Exhibit 200, Morgan at 4, lines 10-18. This  
14 may be true in abstract economic theory but the critical question here is how the  
15 Commission should apply the Court of Appeals ruling on remand. We believe that  
16 regulatory policy should guide that and, in this view, have suggested that the Commission  
17 consider whether the precluded "profit" is really the cost of capital in total or just the cost of  
18 the common equity. We noted several jurisdictions that had made just such a distinction.



**III. Cost of Capital Issues in Staff Exhibit 200**

1 **Q. Please summarize this Section of your testimony.**

2 A. In this Section, we discuss areas of agreement and disagreement with Staff positions  
3 regarding PGE's cost of capital.

4 **Q. Please review the conclusions that Staff draws regarding the effects of the Court of**  
5 **Appeals decision on PGE's cost of capital.**

6 A. Staff concludes that: "assuming a short amortization period for recovery of Trojan  
7 investment, there would be no negative impact on PGE's cost of capital, and no permanent  
8 impact on the capital structure that would have affected the cost of capital." Staff Exhibit  
9 200, Morgan at 3, lines 6-10. Staff supports its conclusion with financial theory. Staff  
10 Exhibit 200, Morgan at pages 5-15. Staff further concludes that: "Primarily because of the  
11 assumptions proposed in Staff Exhibit 100, the cost of capital issue is not a key element of  
12 this case." Staff Exhibit 200, Morgan at 24, lines 16-17.

13 **Q. With what parts of this testimony do you agree?**

14 A. As a matter of regulatory policy and factual analysis, we generally agree with Staff's  
15 conclusion that the effect on the cost of capital (debt and equity) is small if the Commission  
16 uses a very short amortization period in this UE 88 remand. The difference between Mr.  
17 Morgan's estimates for PGE's cost of capital and our estimates under this scenario is very  
18 small. Consequently, the revenue requirement difference would also be very small. Thus,  
19 we also agree that the cost of capital is not a key issue in this case if the Commission  
20 considers only alternatives with a very short amortization period for Trojan. If the recovery  
21 period is long or if investors do not recover a significant portion of their investment, then  
22 there may be an effect on PGE's cost of capital. Staff Exhibit 100, Busch-Johnson at 5,

1 lines 15-21. Further, we appreciate and agree with Staff’s discussion that the Commission  
2 could have granted PGE additional compensation if the financial impact of the original or  
3 remanded UE 88 decision was great. Staff Exhibit 200, Morgan at 25, lines 6-12.

4 **Q. Did Staff explore the possibility of a cost of capital effect if the recovery period is long**  
5 **or if investors do not recover a significant portion of their investment?**

6 A. No, not really. As Staff noted, their cost of equity analysis is premised on the Commission  
7 adopting their recommendation for PGE to recover its investment over one year. Staff’s cost  
8 of debt analysis also assumed only a one-year impact on PGE’s financials. Staff does not  
9 analyze the scenario where PGE recovers its investment over a long period of time without  
10 interest or where PGE does not recover a significant portion of its investment. Mr. Morgan  
11 notes that “If the Commission had found, in UE 88, that the financial impact would have  
12 been great, the Commission could have provided additional compensation relating to the  
13 cost of capital. It would not particularly have been unreasonable under the circumstances of  
14 providing no return of capital, for example. A complete loss of capital could be considered  
15 to potentially create a large impact on any utility’s financial position.” Staff Exhibit 200,  
16 Morgan at 25, lines 6-12. We agree with Mr. Morgan’s assessment.

17 **Q. With what parts of Staff’s cost of capital testimony do you disagree?**

18 A. We disagree with two areas of Staff’s cost of capital testimony. First, we disagree with  
19 some of the financial theory Staff provides in discussing its conclusions. However, we do  
20 not intend to explore these differences in our rebuttal testimony because, as noted above, we  
21 agree with Staff’s general conclusion assuming a short amortization period and Staff has not  
22 specifically rebutted our testimony regarding the types of adjustments that would have been

1 necessary under a scenario such as our Alternative Three. It makes no sense to explore  
2 issues of theoretical difference if the outcome does not depend upon their resolution.

3 Second, we disagree that “Given a timely recovery of the capital that supported the  
4 Trojan investment, no adjustments to PGE’s cost of equity or cost of debt are warranted by  
5 the remand proceedings covered in this docket.” Staff Exhibit 200, Morgan at 24, lines 3-5.  
6 As Staff notes, we provided the range of returns the Commission had before it when it  
7 approved the stipulated ROE in UE 88. We discussed above that one cannot be sure now, so  
8 many years later, whether there would have been a stipulation on ROE, what the stipulated  
9 ROE would have been or whether the Commission would have chosen a different number,  
10 had no stipulation been presented. As a matter of regulatory policy, we believe the  
11 Commission can consider the effect of choosing a slightly different ROE in its determination  
12 of whether the UE 88 rates were just and reasonable and whether adopting the UM 989  
13 stipulation was within its authority and discretion.

14 Whether investors in 1995 would have demanded a slightly higher return on PGE’s  
15 equity would depend on whether they believed that they were adequately compensated by  
16 the Commission and what they believed the Commission would do in similar situations in  
17 the future. Even if investors received their principal, however, they would incur  
18 reinvestment risk – the risk that they would not be able to invest their proceeds at the  
19 original, and higher, rate of return. Thus, rational investors would demand a slightly higher  
20 return. But, again, we note that Staff and PGE agree that the cost of capital effect would be  
21 small. Staff believes it would be zero. PGE believes it would be about 25 basis points.

1 **Q. On Page 20 of Staff Exhibit 200, Mr. Morgan states that “PGE did not rigorously**  
2 **apply any known cost of capital techniques to determine its ‘risk premium’**  
3 **adjustments to the cost of equity.” Do you agree with this statement?**

4 A. No. In developing its UE 88 cost of capital estimates, PGE used several methods, including  
5 the Discounted Cash Flow model (DCF) and the Capital Asset Pricing model (CAPM). At  
6 that time, we assumed full recovery of PGE’s Trojan investment. We also provided  
7 testimony and analysis on the effect of different Trojan return scenarios on PGE’s  
8 financials.

**IV. Issues Raised in URP Exhibit 200**

1 **Q. Please summarize this section of your testimony.**

2 A. In this Section, we discuss the problems associated with several suggestions made by Mr.  
3 Lazar in URP Exhibit 200. Mr. Lazar's suggestions concern:

- 4 • Amounts collected between the time PGE closed Trojan and April 1, 1995.
- 5 • The characterization of certain balances involved in the UM 989 proceeding.
- 6 • PGE's earnings after the Commission's decision in UE 88.
- 7 • Plants whose construction was never completed.

8 **Q. On Page 13 of URP Exhibit 200, Mr. Lazar suggests that the Commission might also**  
9 **consider "The amounts collected between actual permanent closure of the plant in**  
10 **November 1992 and April 1, 1995." Would it be appropriate for the Commission to**  
11 **consider these amounts?**

12 A. No. As stated in the Commission's October 18, 2004 Order of Scope, the task for Phase I of  
13 this docket was set out as the "examination of what rates would have been approved in  
14 UE 88 if the Commission had interpreted the authority delegated to it by the legislature in  
15 ORS 757.355 to not allow a return on investment in retired plant." Amounts collected  
16 between November 1992 and April 1, 1995 are outside of the scope established by the Order  
17 of Scope, as UE 88 rates did not become effective until April 1, 1995.

18 **Q. Also, on Page 13 of URP Exhibit 200, Mr. Lazar suggests that the Commission might**  
19 **consider "The lump-sum transfers made from ratepayers to shareholders in 2000 in**  
20 **the UM 989 case" and "The value of the phantom regulatory asset created by the**  
21 **Commission to replace Trojan in 2000." What is your response to this comment?**

1 A. Mr. Lazar refers to the UM 989 settlement. However, he offers no evidence beyond that  
2 submitted in the UM 989 proceeding. PGE relies on previously filed testimony, UM 989,  
3 Staff – PGE / 200.

4 **Q. On Page 2 of URP Exhibit 200, Mr. Lazar asserts that “PGE significantly overearned**  
5 **its allowed return during much of this period.” Would it be appropriate for the**  
6 **Commission to consider this issue in this proceeding?**

7 A. No. The Commission sets rates so that a utility has an opportunity “on average” to earn its  
8 authorized return on equity. Sometimes the utility earns more than its expected return on  
9 equity; sometimes it earns less. Earnings in any particular year depend on many factors,  
10 particularly hydro conditions and market gas and electric prices. In fact, some of these and  
11 other factors combined so that PGE’s earned less than its authorized return on equity in the  
12 years 1999 through 2003.

13 **Q. On Pages 14 and 15 of URP Exhibit 200, Mr. Lazar discusses several generating plants**  
14 **whose construction was discontinued prior to completion. In this discussion he makes**  
15 **two points. First, in none of these cases was the utility allowed to collect a return on its**  
16 **investment. Second, in these cases, to the extent that a utility was allowed to recover**  
17 **any of the “principal,” this took place over a period of at least five years, i.e. a period**  
18 **substantially greater than the one-year period that is part of Staff’s and some of PGE’s**  
19 **recommendations. What is your response to this testimony?**

20 A. The generating plants Mr. Lazar discusses were all discontinued before construction was  
21 complete, whereas Trojan provided service for many years before PGE closed it in 1993.  
22 Therefore, the discussion on Pages 14 and 15 of URP Exhibit 200 is not relevant to this

1 proceeding. However, Mr. Lazar's discussion of these plants helps illustrate an important  
2 difference for Trojan.

3 **Q. What difference is that?**

4 A. PGE operated Trojan for 16 years before shutting down the plant for economic reasons.  
5 When PGE put Trojan in service, nobody knew precisely how long it would operate. As a  
6 result, the Commission set depreciation rates to return the investment in the plant to the debt  
7 and equity investors over an assumed life set at 35 years. During its operating life, the plant  
8 was used and useful and provided value to PGE customers. The reason Trojan had an  
9 "undepreciated balance" when we retired it is because nobody could foretell precisely how  
10 long Trojan would be economic to operate. This same issue exists with many major assets  
11 built to provide utility service. It is true with telephone switches, underground natural gas  
12 storage, hydro dams and coal plants to name a few.

13 The challenge for the Commission is to provide an incentive for a utility to retire a plant  
14 with an "undepreciated balance" if the retirement provides an overall benefit to customers.  
15 The Commission approved recovery of the "return of" Trojan, finding its retirement, prior to  
16 the ratemaking depreciation life set for it, to be "in the public interest" and specifically, a net  
17 benefit to customers. The Court of Appeals decision on appeal of UE 88 concluded that  
18 PGE was allowed to recover through rates the principal amount of its undepreciated  
19 investment in Trojan. As other testimony in this case concludes, the recovery of the  
20 undepreciated balance over an extended period of time would raise the cost of capital  
21 demanded by investors in Oregon utilities.

22 The plants Mr. Lazar uses in his comparison are plants that were never in service and  
23 presumably never provided any benefits to customers. Recovery of amounts invested in the

- 1 never-operated plants Mr. Lazar mentions was also not under Oregon law. Therefore, his
- 2 examples are of different circumstances and different laws.



**V. Issues Concerning Scope of Analysis in URP Exhibit 204**

1 **Q. Please summarize this section of your testimony.**

2 A. In this Section, we do two things. First, we discuss the timing by which the facts and policy  
3 options we presented in our building blocks were known. All were known and knowable at  
4 the time the Commission entered Order No. 95-322 in Docket UE 88. Second, we discuss  
5 the “new facts” introduced by Mr. Meek in URP Exhibit 204, which were not knowable at  
6 the time the Commission entered Order No. 95-322.

7 **Q. On Page 8 of URP Exhibit 204, Mr. Meek states that “PGE offers selective new ‘facts’**  
8 **for the OPUC to consider,” and that “This includes several facts that were unknowable**  
9 **by anyone in 1995.” Is this an accurate characterization of the recommendations made**  
10 **by PGE?**

11 A. No. All of the elements of PGE’s analyses and recommendations were known on March 29,  
12 1995 when the Commission entered its Order No. 95-322. These analyses and  
13 recommendations included the following:

- 14 • The possibility of increasing PGE’s allowed return on equity, based on ranges  
15 introduced in UE 88. See PGE/700.
- 16 • The possibility of collecting the Trojan balance over a one-year period. See  
17 Appendix A to Order No. 93-1117, Department of Justice Letter, OP-6454, dated  
18 June 8, 1992.
- 19 • The possibility of restoring all or part of the \$26.8 million (pre-tax) disallowance.  
20 See Order No. 95-322 at Pages 33-52.
- 21 • The possibility of accelerating the Boardman gain refund. See PGE/100 at Page 9  
22 and Order No. 95-322 at Pages 17-18.

- 1           • The possibility of deferring some of the UE 88 first-year power costs for later  
2           collection.
- 3           • The possibility of deferring the collection of certain regulatory assets for later  
4           collection.
- 5           • The possibility of classifying some of the outstanding Trojan balance as “in service.”  
6           See PGE/900 at Page 43 and Order No. 95-322 at Pages 53-54.
- 7           • The possibility of authorizing PGE to share in the net benefits test based savings from  
8           the decision to close Trojan.

9           Again, the policies and factual bases for PGE’s analyses and recommendations were all  
10          known in 1995. Mr. Meek’s statement that they were “unknowable by anyone in 1995” is  
11          simply incorrect.

12       **Q. Mr. Meek then asserts that the Commission should consider his “new facts.” What are  
13          the other “new facts” that Mr. Meek believes the Commission should consider?**

14       A. Mr. Meek discusses the following “new facts,” which really were not knowable in 1995  
15          when the Commission entered Order No. 95-322:

- 16           • Enron purchased PGE at a premium in July 1997, resulting in a gain for PGE’s equity  
17           holders.
- 18           • PGE earned more than its authorized return on equity during part of the 5.5-year  
19           period after April 1, 1995.
- 20           • UE 88 rates were based on a “stand-alone” utility model, under which the utility pays  
21           federal and state income taxes, but once Enron purchased PGE in 1997, PGE’s results  
22           became part of Enron’s consolidated results, and Enron’s net losses resulted in low or  
23           no taxes.

1 **Q. Is Mr. Meek correct in his assertion that both the “new elements” used by PGE in its**  
2 **analyses and recommendations and the “new facts” that he wants the Commission to**  
3 **consider were “unknowable by anyone in 1995?” (URP Exhibit 204, Page 8)**

4 A. No. As stated above, all facts underlying or used in PGE’s recommendations were known  
5 in 1995 when the Commission made its decisions in the UE 88 docket. However, none of  
6 Mr. Meek’s “new facts” were knowable, let alone known, in 1995. Moreover, as explained  
7 below, ratemaking does not recognize any of Mr. Meek’s “new facts.”

8 **Q. Do you agree with Mr. Meek’s characterizations of his “new facts?”**

9 A. No. His characterizations are incomplete and misleading.

10 **Q. Please explain why you disagree with Mr. Meek’s proposed use in this proceeding of**  
11 **gains to PGE’s equity holders that resulted from Enron paying a premium to purchase**  
12 **PGE.**

13 A. Gains or losses on stock sales are not recognized in ratemaking. Rates are set based on the  
14 original cost of assets adjusted for accumulated depreciation. Changes in market value as  
15 represented by increases and decreases in stock prices are not reflected in rates.

16 **Q. Please explain why you disagree with Mr. Meek’s proposed use in this proceeding of**  
17 **PGE’s earnings during the 1995-2000 period.**

18 A. A utility cannot recover losses in subsequent years, nor can it pass through gains in  
19 subsequent years, absent very specific conditions covered by Oregon law. If a utility cannot  
20 do this in a going forward rate case, it cannot do it in a remand either.

21 **Q. Please explain in more detail why you disagree with Mr. Meek’s criticism of UE 88**  
22 **rates as being based on a “stand-alone” utility model, under which the utility pays**  
23 **federal and state income taxes?**

1 A. This is not a “new fact,” but a well established ratemaking policy of the Commission when  
2 it set rates in UE 88. PGE had been consolidated for tax purposes with its then parent,  
3 Portland General Corporation (PGC) since 1986. The Commissioner approved PGC’s  
4 acquisition of PGE in Order No. 86-106, entered January 31, 1986.

5 **Q. Should the Commission consider Mr. Meek’s “new facts” in this proceeding?**

6 A. No. His “new facts” were not knowable in 1995 when the Commission made its UE 88  
7 decisions. In addition, as discussed above, his application of these new facts is at least poor  
8 ratemaking practice. We will leave to briefs our discussion of the legality of his proposals.

**VI. Policy Issues Raised in URP Exhibit 204**

1 **Q. Please summarize this section of your testimony.**

2 A. In this Section, we address policy issues raised by Mr. Meek in URP Exhibit 204. These  
3 include:

- 4 • Characterization of the disallowance that would be inherent in collecting the Trojan  
5 balance over almost 17 years, without any return.
- 6 • Role of incentives in utility decision making.
- 7 • Relevance of “ability to attract capital” standard.
- 8 • Classification of a portion of Trojan as plant in service as of April 1, 1995.
- 9 • Intergenerational equity in the context of a one-year Trojan collection period.

10 **Q. On Page 17 of URP Exhibit 204, Mr. Meek states, in reference to your prior testimony**  
11 **(PGE Exhibit 6000), “She often refers to a ‘disallowance of \$182 million.’ But that is a**  
12 **disallowance from an unlawful number, recovering all of Trojan investment with full**  
13 **return on investment in it.” Do you agree with Mr. Meek’s characterization?**

14 A. No. We disagree with this characterization for three reasons. First, the relevant testimony  
15 only refers twice to a “disallowance of \$182 million.” PGE Exhibit 6000, Lesh at pages  
16 20-21. Second, the \$182 million figure is the net present value of the return foregone if  
17 Trojan were collected over 17 years with no return, or, as stated in this prior testimony,  
18 “leaving the amortization period for Trojan’s un-depreciated investment at 17 years without  
19 a return is the same as an initial disallowance of \$182 million.” PGE Exhibit 6000, Lesh at  
20 20, lines 12-13. Third, there is nothing “unlawful” about returning the undepreciated Trojan  
21 balance to PGE’s investors.

1 **Q. On Page 15 of URP Exhibit 204, Mr. Meek states, in reference to your prior testimony**  
2 **in PGE Exhibit 6000, “She claims (p. 16) that utilities need lots of incentives....By the**  
3 **time PGE even filed its UE 88 rate request, Trojan had been permanently closed for**  
4 **nearly two years....One cannot provide an incentive in 2005 for a utility to take an**  
5 **action in 1992 or 1993, because time does not run backwards.” Do you agree with Mr.**  
6 **Meek’s characterization of your testimony?**

7 A. No. The Commission’s decisions in this docket, which concerns a decision already made,  
8 will affect incentives for utility decisions in the future. Good ratemaking aligns interests  
9 over the long term. Mr. Meek misses this point. PGE made its decision to permanently  
10 close Trojan more than 12 years ago, and Commission decisions in UE 88 and in this docket  
11 will determine the financial consequences to PGE of that decision. PGE and investors in  
12 Oregon utilities will consider the financial consequences of a decision to close Trojan when  
13 they make future decisions. If PGE were to incur a large financial penalty from having  
14 closed Trojan rather than having continued to operate this plant, even though PGE’s analysis  
15 indicated that closure was the best alternative for customers, PGE would be much less likely  
16 to make future decisions to close plants before the end of their expected lives, even if  
17 closure is the least-cost alternative for customers.

18 **Q. On Page 9 of URP Exhibit 204, Mr. Meek states that “Further, as of Enron’s closing of**  
19 **the PGE deal in 1997, there remained no PGE common stock traded on financial**  
20 **markets, thus eliminating the rationale that PGE needed higher rates in order to**  
21 **attract equity capital.” Do you agree with Mr. Meek’s statement?**

22 A. No. Including the cost of equity capital, which includes the “ability to attract capital,” in  
23 cost of service does not depend on the number of a utility’s equity owners. Whether there

1 are millions of equity owners, or only one, the cost of equity is a necessary cost. We can  
2 discern no reason to discriminate between the number of owners when setting a fair return  
3 for Oregon utility investors. A wholly-owned subsidiary must still attract equity capital  
4 from its parent through dividend policies and capital infusions. In addition, the “ability to  
5 attract capital” standard also covers debt. Even with Enron as the single equity owner, PGE  
6 still had to attract debt capital on its own. Mr. Meek’s statement overlooks this fact.

7 **Q. On Pages 15 and 16 of URP Exhibit 204, Mr. Meek argues against the classification of**  
8 **a portion of the April 1, 1995 Trojan balance as plant in service, claiming that this is**  
9 **“not the ‘utility service’ required by ORS 757.355.” Do you agree with Mr. Meek’s**  
10 **characterization of the Trojan balance from a plant in service perspective?**

11 A. No. This appears to be a legal conclusion of Mr. Meek and will be addressed in briefs later  
12 in this case. Mr. Busch and Ms. Johnson of OPUC Staff, on Pages 16 and 17 of Staff  
13 Exhibit 100, explain why it would have been appropriate to classify part of the April 1, 1995  
14 Trojan balance as plant in service. They state that “There are several reasons that support  
15 classification of a portion of Trojan investment as plant in service....They were ‘used and  
16 useful’ in carrying out activities related to safety, environmental protection or  
17 decommissioning .PGE requested the FERC Chief Accountant’s approval to continue to use  
18 Account 101, Plant in Service, ‘for Trojan assets that will continue to operate and provide  
19 utility benefit following the plant closure.’ The Chief Accountant approved PGE’s request  
20 in April 1993....in UE 88 ‘neither Staff nor the Commission explicitly disagreed with  
21 PGE’s method to identify Trojan plant-in-service....Finally, Order 95-322 at 53 stated the  
22 Commission’s belief that ‘[b]ecause both [FERC 101 and 182.2] accounts are included in  
23 PGE’s rate base, transferring investment between the accounts will not affect the rate base.’

1 In other words, it didn't make a difference in the original UE 88 decision whether Trojan  
2 assets were classified as plant in service or abandoned plant. We believe that it is highly  
3 likely the Commission would have allowed these assets to remain in plant in service had it  
4 known that plant which was truly 'abandoned' could not be included in rate base and earn a  
5 return." Staff Exhibit 100, Busch-Johnson at pages 16-17. Staff's explanation effectively  
6 rebuts Mr. Meek's erroneous characterization.

7 **Q. On Page 16 of URP Exhibit 204, Mr. Meek, in the context of discussing the**  
8 **classification of part of the Trojan balance as plant in service, states that it would**  
9 **encourage the building of dangerous plants. Do you agree with Mr. Meek's belief?**

10 A. No. Mr. Meek overlooks the role played by the Commission. The Commission must rule  
11 on the prudence of costs incurred. In fact, in UE 88, the Commission ordered \$37.5 million  
12 (after-tax) in Trojan-related disallowances. Order No. 95-322, at page 52.

13 **Q. On page 17 of his testimony, Mr. Meek claims that PGE is asking for a regulatory**  
14 **regime in which the most profitable course is to operate a plant poorly so it needs**  
15 **replacement – so profits can be earned on both plants. What is your response to this**  
16 **claim?**

17 A. Mr. Meek assumes a "straw man" regulatory regime very different from the sound policy  
18 adopted by the Commission. Only when it is economical to close a plant for the benefit of  
19 customers would the utility ask that the full undepreciated balance be returned. If that  
20 balance is returned over a short period of time, then there is no "profit." If there is a  
21 replacement plant, the utility would have to raise capital to build the new plant. Part of this  
22 would be new equity capital. If the plant is prudent and included in rate base, there is a



1 return on this plant, but no further return on the plant that was closed for reasons beneficial  
2 to customers. In short there is no “double” return as Mr. Meek claims.

3 **Q. On Page 17 of URP Exhibit 204, Mr. Meek criticizes a recommendation you made in**  
4 **PGE Exhibit 6000, stating that “She recommends amortizing the book value of the**  
5 **plant over one year. She never explains how that would be consistent with her musings**  
6 **about intergenerational equity.” Is Mr. Meek’s criticism valid?**

7 A. No. The recommendations made by PGE in its direct testimony, and by Staff in Staff  
8 Exhibit 100, employ smoothing methods to alleviate intergenerational equity concerns.  
9 Collections of other amounts are spread out over longer periods of time to offset the rate  
10 effects of collecting all or part of the April 1, 1995 Trojan balance over a one-year period.

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**UE-88 REMAND / PGE / 6900  
HAGER - TINKER - SCHUE**

**BEFORE THE PUBLIC UTILITY COMMISSION  
OF THE STATE OF OREGON**

# **Quantitative Analysis**

**PORTLAND GENERAL ELECTRIC COMPANY**

Rebuttal Testimony of

*Patrick G. Hager  
Jay Tinker  
Stephen Schue*

**June 27, 2005**

**I. Introduction**

1 **Q. Please state your names and qualifications.**

2 A. My name is Patrick Hager. My position is Manager, Regulatory Affairs. My qualifications  
3 are in Section IV of PGE Exhibit 6400.

4 My name is Jay Tinker. My position is Project Manager in the Rates and Regulatory  
5 Affairs Department. My qualifications are in Section X of PGE Exhibit 6200.

6 My name is Stephen Schue. My position is Senior Analyst in the Rates and Regulatory  
7 Affairs Department. My qualifications are in Section X of PGE Exhibit 6200.

8 **Q. What is the purpose of your testimony?**

9 A. The purpose of our testimony is to rebut statements made by Mr. Lazar in URP Exhibit 200  
10 on methodology and other issues.

11 **Q. How is your testimony organized?**

12 A. Our testimony is organized into two Sections. Section I is this introduction. In Section II  
13 we address methodological issues raised by Mr. Lazar in URP Exhibit 200.

14 **Q. Do you also address policy issues raised by Mr. Lazar?**

15 A. No. Policy issues are addressed in PGE Exhibit 6800.

## II. Methodological Issues

1 **Q. Please summarize this Section of your testimony.**

2 A. In this Section, we discuss several errors made by Mr. Lazar in URP Exhibit 200. These  
3 include:

- 4 • Failure to consider that the outstanding Trojan balance declined over the 5.5-year  
5 period beginning April 1, 1995.
- 6 • Misspecification of the Trojan balance used in the Commission's UE-88 decisions.
- 7 • Incorrect use of a pre-tax cost of capital to consider the time value of money in his  
8 calculations.
- 9 • Erroneous statements about the disposition of accumulated deferred income taxes if  
10 PGE had to write-off its Trojan investment on April 1, 1995.
- 11 • Incorrect characterization of a situation under which PGE would be allowed the  
12 return of Trojan over a 17-year period, but without any return on the outstanding  
13 balance over that period.

14 **Q. Does Mr. Lazar's analysis take into consideration the fact that the outstanding Trojan**  
15 **balance on PGE's books was declining over the 5.5-year period (beginning April 1,**  
16 **1995)?**

17 A. No. Mr. Lazar assumes that the April 1, 1995 balance is the correct balance to use for the  
18 entire 5.5-year period. This is inconsistent with standard accounting procedures and the  
19 methods used to calculate the earnings PGE reports to the SEC (in our 10-Q and 10-K  
20 reports) and to the OPUC (in our Reports of Operation). It is also inconsistent with the  
21 approach Mr. Lazar previously took in UM 989, Complainants 200, Table URP-1.

1 **Q. What effect does Mr. Lazar’s incorrect estimate for the Trojan plant balance have on**  
2 **his analysis?**

3 A. This error leads to a result that is much higher than would be the case if Mr. Lazar had  
4 recognized the decline in PGE’s Trojan balance that occurred over the 5.5-year period. The  
5 impact of this error under Mr. Lazar’s “alternative methodology” is approximately \$135  
6 million. PGE does not have sufficient information to determine the impact of this error  
7 under Mr. Lazar’s “recommended methodology.” We explain below why the treatment of  
8 accumulated deferred taxes in his “recommended methodology” is flawed.

9 **Q. Does Mr. Lazar make another error in his assumption on the size of the Trojan**  
10 **balance over the 5.5-year period?**

11 A. Yes. Mr. Lazar assumes that UE 88 rates were determined using the Trojan plant balance as  
12 of April 1, 1995. This is incorrect. The Commission based the Trojan return component of  
13 UE 88 rates on the average Trojan plant balance over the relevant 1995 and 1996 test years.

14 **Q. What effect does this incorrect estimate of the Trojan plant balance have on Mr.**  
15 **Lazar’s analysis?**

16 A. This error leads to a higher result than had Mr. Lazar correctly recognized that the Trojan  
17 return component of UE 88 rates was based on Trojan balances lower than the April 1, 1995  
18 figure. The impact of this error under Mr. Lazar’s “alternative methodology” is  
19 approximately \$62 million. PGE does not have sufficient information to determine the  
20 impact of this error under Mr. Lazar’s “recommended methodology.”

21 **Q. Is the \$62 million impact of this error cumulative with the \$135 million impact of the**  
22 **erroneous assumption that the Trojan balance was not declining over the 5.5-year**  
23 **period beginning April 1, 1995?**

1 A. No. Most of the \$62 million is included in the \$135 million impact.

2 **Q. Does Mr. Lazar use more than one interest rate to recognize the time value of money**  
3 **to customers in his calculations?**

4 A. Yes. In some of his calculations, Mr. Lazar uses the overall PGE weighted pre-tax cost of  
5 capital approved by the Commission in Order No. 95-322, 13.22% through December 31,  
6 1995, 13.34% thereafter. In other calculations, which are based on a capital structure  
7 adjustment, he adjusts the 13.34% to 12.71%.

8 **Q. Should Mr. Lazar use PGE's pre-tax cost of capital in his calculations?**

9 A. No. Mr. Lazar uses these rates to convert his calculation results to December 31, 2005  
10 equivalents. For this purpose, it is incorrect to use a measure of PGE's pre-tax cost of  
11 capital. Mr. Lazar should have used PGE's authorized cost of capital, which was 9.51%  
12 from April 1, 1995 through December 31, 1995, and 9.60% thereafter. The OPUC allows  
13 interest on deferral balances, either owed to customers or owed to the utility, to accrue at a  
14 utility's authorized cost of capital.

15 **Q. Does Mr. Lazar provide a reason for his use of 13.34% instead of 9.60% for interest**  
16 **charges?**

17 A. Yes. On Page 4 of URP Exhibit 200, Mr. Lazar states that "This is the amount that  
18 ratepayers pay in revenues for an asset included in the utility's rate base. It includes the  
19 return to equity investors, the return to debt investors, and the amount included in rates for  
20 payment of state and federal income taxes ..."

21 **Q. Is this reason valid?**

1 A. No. Neither regulatory decisions nor other court-driven plaintiff awards include taxes the  
2 plaintiff might owe. Thus, Mr. Lazar should use PGE's authorized cost of capital, not  
3 PGE's pre-tax cost of capital.

4 **Q. What effect does Mr. Lazar's use of PGE's pre-tax cost of capital, rather than its  
5 authorized cost of capital, have on his analysis?**

6 A. Mr. Lazar's incorrect use of PGE's pre-tax cost of capital increases his result substantially,  
7 as his error is compounded over several years. Under Mr. Lazar's "recommended  
8 methodology," the impact of this error is approximately \$149 million. Under his  
9 "alternative methodology," the impact is approximately \$125 million.

10 **Q. Are the \$135 million and \$125 million impacts from the errors under Mr. Lazar's  
11 "alternative methodology" cumulative?**

12 A. No. There is some overlap. The combined impact of not recognizing that the Trojan  
13 balance was declining over the 5.5-year period beginning April 1, 1995, and incorrectly  
14 using a pre-tax measure of PGE's cost of capital, rather than PGE's authorized cost of  
15 capital, is approximately \$230 million.

16 **Q. How does your \$230 million estimate relate to the summary Mr. Lazar provides on  
17 Page 1 of URP Exhibit 202?**

18 A. Our \$230 million estimate relates to Mr. Lazar's Alternative Methodology column in URP  
19 Exhibit 202. It is a correction to his \$522.862 million figure for "Total associated with  
20 Overcharges." We also note that the entire \$164.623 million labeled "Total associated with  
21 Deferred Taxes" is erroneous because, as we explain below, there is no basis for the  
22 "Principal associated with Deferred Taxes."

1 **Q. You stated that Mr. Lazar's treatment of accumulated deferred taxes is flawed. What**  
2 **does Mr. Lazar state about the April 1, 1995 Trojan-related accumulated deferred**  
3 **income tax balance?**

4 A. He states that this balance should have been given to customers on that date. In his  
5 calculation, he then adds interest to bring this figure forward to December 31, 2005.  
6 However, it should be noted that, although he intends to bring an April 1, 1995 figure  
7 forward to December 31, 2005, Mr. Lazar's calculations in URP Exhibit 202 incorrectly  
8 take an April 1, 1995 figure, and then move it from October 1, 2000 to December 31, 2005.

9 **Q. What is the basis of Mr. Lazar's treatment of the accumulated deferred tax balance?**

10 A. On Pages 9 and 10 of URP Exhibit 200, Mr. Lazar assumes that the undepreciated balance  
11 in Trojan would be completely written off and the taxes never collected.

12 **Q. Is Mr. Lazar's reasoning valid?**

13 A. No. Mr. Lazar's underlying assumption is wrong. He assumes that, had the OPUC known  
14 of the court's ruling at the time of UE 88, it would have required that PGE immediately  
15 write off the entire Trojan investment balance. There is no basis for this assumption. A  
16 write-off of the entire Trojan balance would only occur if the Commission ruled that PGE is  
17 due neither a return on nor a return of the existing Trojan balance. Second, even if PGE  
18 were requested to immediately write off its investment, the associated deferred taxes would  
19 not be owed to customers. If the Commission were to rule that the entire Trojan balance  
20 should have been written off at the time of UE-88, it is unclear why customers should be  
21 given credit for the reversal of deferred taxes if they aren't responsible for the remaining  
22 investment in the Trojan plant. Deferred taxes, as well as their reversals, should follow the  
23 responsibility of the underlying investment. Since PGE shareholders would absorb the



1 entire write-off of the remaining Trojan investment under the scenario Mr. Lazar describes,  
2 any deferred tax reversals should similarly follow the treatment of the underlying  
3 investment and not be refunded to customers.

4 **Q. Mr. Lazar's recommendation on Page 16 of URP Exhibit 200 is based on assuming a**  
5 **write-off of the Trojan balance on April 1, 1995 and related adjustments to PGE's**  
6 **capital structure and pre-tax cost of capital. Is this a basis for sound analysis?**

7 A. No. Again Mr. Lazar's error is that he assumes a full write off is required in this case.  
8 Since this assumption is not correct, his "adjustment" to the capital structure is  
9 inappropriate. Even if the Commission had only allowed PGE to collect the outstanding  
10 balance of Trojan over a period of almost 17 years, with no return, accounting rules would  
11 not require a full write-off. The collection of approximately \$340 million over 17 years has  
12 a net present value considerably less than \$340 million, but much greater than zero.

13 **Q. Does this conclude your testimony?**

14 A. Yes.

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**UE-88 REMAND / PGE / 7000  
BLAYDON**

**BEFORE THE PUBLIC UTILITY COMMISSION  
OF THE STATE OF OREGON**

# **Impact on Rate of Return**

**PORTLAND GENERAL ELECTRIC COMPANY**

Rebuttal Testimony of

*Colin C. Blaydon, Ph.D*

**June 27, 2005**

**I. Introduction**

1 **Q. Please state your name, occupation and business address.**

2 A. My name is Colin C. Blaydon. I am Dean Emeritus and the William and Josephine  
3 Buchanan Professor of Management at the Tuck School of Business. My business address is  
4 the Tuck School of Business, 100 Tuck Hall, Dartmouth College, Hanover, NH 03755.

5 **Q. Have you filed testimony and qualifications here before?**

6 A. Yes. I have previously submitted direct testimony in this matter. A discussion of my  
7 qualifications was provided in Section IV of my direct testimony; my curriculum vitae was  
8 attached as PGE Exhibit 6601 to that report.

9 **Q. What is the purpose of your testimony?**

10 A. I have been asked by Portland General Electric Company (PGE) to respond to the direct  
11 testimony submitted by the Commission staff and intervenors in this matter related to issues  
12 concerning the cost of capital. In particular, I address the opinions offered by staff witnesses  
13 Ed Busch, Judy Johnson, and Thomas Morgan and those offered by intervenor witnesses  
14 Daniel W. Meek and Jim Lazar.

15 **Q. Please summarize the conclusions you reach in your testimony.**

16 A. I reach two fundamental conclusions. First, I conclude that Mr. Meek and Mr. Lazar's  
17 characterization of PGE (and staff) proposals to address the Court of Appeals interpretation  
18 of disallowing any return on the undepreciated balance of a utility plant that is retired for  
19 economic reasons as being based on a "model of corrupt regulation" demonstrates a  
20 fundamental misunderstanding of the necessary economic incentives that the Commission  
21 seeks to provide: (1) to achieve a fair and reasonable return required to attract investors in

1 utility assets; and (2) to ensure that the least cost operating alternatives that are in the best  
2 interests of customers are pursued by the utility.

3 Second, I conclude that, depending on the period of recovery and magnitude of the lost  
4 return on investment for plants that are retired early, non-diversifiable risks for utilities  
5 operating in the State of Oregon are higher than typical utility companies operating in other  
6 states. As a result, the returns required by investors in Oregon utilities necessarily will be  
7 higher as well.

**II. Response to Intervenor Witnesses Lazar and Meek**

1 **Q. Do you agree with Mr. Meek and Mr. Lazar’s characterization of PGE’s testimony as**  
2 **depending “upon a model of corrupt regulation which rewards unreasonable utility**  
3 **conduct”?**

4 A. No. Mr. Meek and Mr. Lazar opine that PGE’s “what if” scenarios, which attempt to predict  
5 the actions the Commission would have taken had it understood that PGE would not be  
6 allowed to recover a return on equity for the undepreciated balance of utility assets that are  
7 retired early, “portrays ratemaking by a utility commission as an essentially corrupt  
8 endeavor” that pieces “together any and all possible rationales to support” a “predetermined  
9 outcome” of revenue requirement. What Mr. Meek and Mr. Lazar fail to recognize,  
10 however, is that the Commission needs to provide the utility with a fair return on its capital  
11 in order to be able to continue to attract investors and to provide the proper incentives to  
12 pursue least cost alternatives that are in the best interests of customers. This crucial fact  
13 implies that, if the law truly can be interpreted to mean that a utility will be denied a fair  
14 return on its investment, then the Commission will have to determine an alternative way to  
15 ensure that investors can be made whole. If investors are denied a return on capital of a  
16 portion of their investment in plants that are retired early, then investors can be made whole  
17 either (1) by returning their capital to them immediately, or (2) by increasing the allowed  
18 rate of return on the remaining asset base, while allowing a long-term recovery of (but not  
19 on) the undepreciated balance. Clearly, no investor would be willing to provide capital if  
20 the rules of the game were such that the Commission would hold the investor’s capital over  
21 an extended period, but would not provide any compensation during the lock up period.

1           Furthermore, even if we ignore the problem of being unable to attract investors under the  
2 scenario that the intervenor witnesses would like to posit, the Commission also must  
3 recognize that the economic incentives provided to the utility would not be in the best  
4 interests of its customers. Rather than retiring a utility plant early when it makes economic  
5 sense to do so, another factor that could impact the decision of plant retirement would be the  
6 loss of the return on the undepreciated investment balance. Providing utilities with  
7 incentives to avoid pursuing the least cost alternative clearly is not in the best interests of  
8 customers. The Commission has stated this principal clearly in its UM 989 decision, Order  
9 02-227 at 10-11:

10           In Order No. 95-322 at 2, we expressed the goal of holding customers harmless  
11 for the premature closure of Trojan while also providing PGE with the appropriate  
12 incentives. If we required PGE to give refunds, (leaving aside the fact that we  
13 have no power to do so) utilities would have an incentive to continue to operate  
14 plants past their economic or efficient useful lives.

15 **Q. If regulatory rules have changed fundamentally, is it reasonable for the Commission to**  
16 **reexamine the total rate package that was authorized previously?**

17 A. Yes, it may be necessary to do so in order to avoid adversely impacting customers. That is,  
18 by addressing the problem of eliminating the return on undepreciated assets that were retired  
19 early, and still providing the proper economic incentives to investors and the utility, other  
20 unintended consequences may result if the total rate package is not re-examined. In  
21 particular, if the Commission decides to provide a quick recovery of the undepreciated  
22 balance of a plant that was retired early, then that could result in a large rate shock to  
23 customers. As a result, it would be reasonable, and in the customers' interest, for the  
24 Commission to re-examine other aspects of the rate decision, even though these may not be

1 directly related to the particular issue that caused the Commission to reevaluate previously  
2 authorized rates.

3 **Q. Do the staff witnesses agree that the Commission has an interest in providing the**  
4 **proper economic incentives to PGE and that may require the Commission to re-**  
5 **examine the totality of rates previously authorized?**

6 A. Yes. The direct testimony of staff witnesses states that “utilities should have the incentive to  
7 acquire the resources needed to serve customers at the least cost. If a utility performs an  
8 analysis demonstrating that acquiring a new resource to replace an existing, uneconomic  
9 resource will result in lower costs for customers – including recovery of the undepreciated  
10 cost of the uneconomic resource – the utility should take that action.” [Staff Exhibit 100 at  
11 5] And further, staff testify that to “mitigate the loss of return on investment, we might  
12 expect the Commission to allow rapid recovery of Trojan but at the same time make other  
13 adjustments to mitigate rate shock.” [Staff Exhibit 100 at 7]

### III. Response to Staff Witnesses

1 **Q. Do the staff witnesses make a critical assumption in reaching their conclusion that**  
2 **investors would not require a higher cost of capital under a scenario where the**  
3 **undepreciated balances of plants retired early would not earn any return on this**  
4 **capital?**

5 A. Yes. Staff witness Thomas Morgan explicitly states that his conclusion “is based on the  
6 assumption that the Commission will adopt staff’s one-year amortization schedule to return  
7 the value of the property. This is an important consideration, because PGE believes that its  
8 financial profile (e.g., impact on financial ratios) would have suffered considerably were the  
9 Commission to require an extended, i.e., 17-year return of capital, without providing a return  
10 on investment.” [Staff Exhibit 200 at 3] Clearly, a critical assumption is the rapid recovery  
11 of the undepreciated balance. If the capital were returned immediately to investors, then  
12 they would not experience any lost opportunity cost on their funds, and therefore, would not  
13 require any additional compensation. However, the converse is equally true; that is, the  
14 longer the period of recovery and the greater the magnitude of the lost return on investment,  
15 the greater will be the impact on the required returns for investors. In fact, the staff  
16 witnesses appear to agree with this proposition as well. They testify that: “If the  
17 Commission . . . required the utility to recover the uneconomic investment over a period of  
18 time without a return on investment (rather than “immediately”), the utility’s investors  
19 would be short-changed through the loss of opportunity cost on their funds. Depending on  
20 the period of recovery and magnitude of the lost return on investment, investors might view  
21 such treatment as increasing risk, *which could lead to higher costs of capital and increased*  
22 *rates in the future.*” [Staff Exhibit 100 at 5, emphasis added]



1 **Q. Do you agree with staff witness Thomas Morgan’s view that the “impact of PGE not**  
2 **recovering a portion of an ‘obsolete’ investment is, by definition, a company-specific,**  
3 **or diversifiable risk” that would not impact the company’s cost of capital?**

4 A. No. As I explained in my direct testimony, since the decision to retire a plant early for  
5 economic reasons is based on a wide range of factors such as the cost to build new  
6 generation, the efficiency of new generation, and demand for new generation, all of which  
7 are correlated with the U.S. economy, the decision to retire a plant is at least partially non-  
8 diversifiable. As discussed above, Mr. Morgan’s view seems to critically depend on the  
9 time horizon of the recovery, or else it is at odds with his own testimony that was jointly  
10 sponsored by the other staff witnesses in Staff Exhibit 100 (cited above). Another critical  
11 assumption that Mr. Morgan makes in reaching his conclusion is that the Trojan situation is  
12 a non-recurring event. He states that a “single event, such as the removal of Trojan from  
13 PGE’s generating portfolio, may have impacted the Company’s share prices in the short run;  
14 *however, as long as the event is viewed as non-recurring, it would not have created an*  
15 *impact on the Company’s cost of equity.” [Staff Exhibit 200 at 8, emphasis added]*  
16 Although PGE undoubtedly would welcome such an interpretation of the Court of Appeals  
17 opinion, another interpretation would suggest that utilities operating in the State of Oregon  
18 have been thrown into a new and unique regulatory environment of which other electric  
19 utilities operating outside of the state are not subject. As a result, depending on economic  
20 factors that are correlated with the economy, future early retirements unrelated to the Trojan  
21 situation are possible. That is why non-diversifiable risks are higher for utilities operating in  
22 Oregon, depending on the period of recovery and magnitude of the lost return on investment  
23 for these “obsolete” investments. This reasoning underlies the basis of my conclusion on

1 page 12 of my direct testimony where I state that:

2 As a result of the new regulatory environment in Oregon, utilities operating in  
3 the state carry significantly more non-diversifiable risk than typical utility  
4 companies operating in other states. Thus, investors will demand an above-  
5 average return on equity in order to invest in Oregon utilities relative to other  
6 electric utilities that do not face this significant risk factor of future disallowances  
7 of the return on undepreciated investments.

8 If the Commission decides that the immediate recovery of undepreciated balances of  
9 obsolete plants is warranted, then the cost of capital may not be impacted. However, the  
10 impact on customers from potential rate shocks may have to be mitigated in each such  
11 instance.

12 **Q. Does this conclude your rebuttal testimony?**

13 A. Yes.

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**J. Jeffrey Dudley**  
Associate General Counsel

June 27, 2005

***Via Messenger and E-Filing***

Public Utility Commission of Oregon  
Attn: Filing Center  
550 Capitol St NE #215  
PO Box 2148  
Salem OR 97308-2148

Re: OPUC Dockets UE 88, DR 10 and UM 989  
Rebuttal Testimony of Portland General Electric Company

Attention: Filing Center

Enclosed for filing in the above-captioned docket are the original and five copies of each of the following documents:

- PGE Rebuttal Testimony of Pamela G. Lesh and Patrick G. Hager: "Policy and Recommendations," Exhibit No. PGE/6800;
- PGE Rebuttal Testimony of Patrick G. Hager, Jay Tinker, and Stephen Schue, "Quantitative Analysis," Exhibit No. PGE/6900; and
- PGE Rebuttal Testimony of Colin C. Blaydon, Ph.D, "Impact on Rate of Return," Exhibit No. PGE/7000.

These documents are also being filed electronically per the Commission's eFiling policy to the electronic address [PUC.FilingCenter@state.or.us](mailto:PUC.FilingCenter@state.or.us), with copies being served on all parties on the service list via U.S. Mail. A photocopy of the PUC tracking information will be forwarded with the hard copy filing.

Thank you in advance for your assistance.

Sincerely,

A handwritten signature in black ink that reads "Jay Dudley / by DCF". The signature is written in a cursive, slightly slanted style.

JJD:am

cc: UE 88 Service List

Enclosures



CERTIFICATE OF SERVICE

I certify that I have this day served the following documents:

- PGE Rebuttal Testimony of Pamela G. Lesh and Patrick G. Hager: "Policy and Recommendations," Exhibit No. PGE/6800;
- PGE Rebuttal Testimony of Patrick G. Hager, Jay Tinker, and Stephen Schue, "Quantitative Analysis," Exhibit No. PGE/6900; and
- PGE Rebuttal Testimony of Colin C. Blaydon, Ph.D, "Impact on Rate of Return," Exhibit No. PGE/7000

by delivering a copy in person or by mailing a copy properly addressed with first class postage prepaid, and by electronic mail pursuant to OAR 860-013-0070, to the following parties from the OPUC

Docket No. UE 88 et al. service list:

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Dated this 27<sup>th</sup> day of June, 2005.

PORTLAND GENERAL ELECTRIC COMPANY

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