

1 **Q. Please state your names and positions with Portland General Electric.**

2 A. My name is Peggy Y. Fowler. I am PGE's Chief Executive Officer and President.

3 My qualifications appear at the end of this testimony.

4 My name is Pamela G. Lesh. I am PGE's Vice President, Rates and  
5 Regulatory Affairs. My qualifications also appear at the end of this testimony.

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

7 A. The purpose of our testimony is to:

- 8 • Explain PGE's objectives for this filing;
- 9 • Discuss how our proposals meet these objectives and lay the foundation for  
10 the future development of customer-oriented electricity service in Oregon; and
- 11 • Identify important policy issues and explain our policy recommendations.

12 **Q. Please begin.**

13 This filing is about our customers and their changed expectations for  
14 service and for electricity. Our customers now expect:

- 15 • More electricity service choices: choices that differ in terms of price (our  
16 index-price rates), terms (the Demand Exchange, a new form of  
17 "interruptible" rate), and content (our Salmon-Friendly and Clean Wind  
18 Power);
- 19 • More payment options: automatic debits, electronic data exchange, on-line  
20 payments over the Internet, and credit and debit card payments;
- 21 • More communication channels: a web site that allows customer service  
22 transactions and e-mail, as well as providing information; and an Interactive

1 Voice Response (IVR) system for reporting outages, receiving outage  
2 information, and checking account information;

- 3 • More information on PGE: regarding our resources, their options, the  
4 industry, and the environment; and in multiple languages;
- 5 • Higher reliability: fewer outages and faster restoration during outages;
- 6 • Better power quality: to run both highly sensitive industrial processes as well  
7 as all of the home electronics we all have, without “bumps” that in past years  
8 would have gone unnoticed;
- 9 • Better safety: more frequent tree trimming to ensure that no power line affects  
10 a tree

11 Our customers also expect available electricity at a relatively stable price even  
12 though the demand for electricity is increasing and the market is now highly  
13 volatile. The loads we serve have increased \_\_\_ percent since 1996, an annual  
14 rate of \_\_\_ and we expect this growth to continue. But load growth rates in  
15 PGE’s service territory alone are no longer essential drivers of the price and  
16 availability of electricity because the entire Western System Coordinating Council  
17 (WSCC) – eleven Western states – now acts as one market. It is the load growth  
18 rate in the WSCC that drives electricity market prices and availability and that  
19 growth accelerated rapidly over the last five years. The economic engine of the  
20 second half of the 1990s produced much value for WSCC residents and  
21 businesses. But this economic engine also placed the whole WSCC on the edges  
22 of electricity shortages. Regulatory uncertainty, siting difficulties and a host of  
23 other reasons inhibited the addition of supply. Demand, fueled by prosperity and

1 real declining prices, grew much faster. Excess demand, coupled with inadequate  
2 reserves, has created high and volatile market prices.

3 The other way in which our customers have changed is that they now  
4 expect choice and innovation. At a minimum, our customers want a choice of  
5 electricity services. But our business customers also want a choice of electricity  
6 suppliers. Fundamentally, our customers want to be customers, and not  
7 ratepayers. The number of products and services for which they have little choice  
8 has shrunk dramatically over the last few decades. We, as individuals and  
9 businesses, have more choices than ever before, among companies working hard  
10 to win not only our minds but our hearts. As we explain later in this filing,  
11 nothing better epitomizes the last evolution in the commercial world than the  
12 advertising slogan: “Have it your way.”

13 For electric utilities and their regulators, this means that the one-size-fits-  
14 all electric service, fueled from a wholly-owned resource base and supported by  
15 some of the most efficient processes in the economy – precisely because those  
16 processes needed deliver only one service – is a thing of the past. Customers will  
17 have it their way, and if we or economic regulation stands in that way, they will  
18 go around us. PGE does not want to rely on stopping this trend to succeed. We  
19 want to succeed because we help our customers get there faster.

20 SB 1149 did not change our customers. Our customers changed first. SB  
21 1149 reacts – as most legislation does – to the changes that had already occurred.  
22 This legislation, and the rules that have followed – led in both instances by our  
23 customers – make clear the following:

- 1           • Our customers do not want us to make future, long-term, resource decisions  
2           for them because they do not want the one-size-fits-all service choice dictated  
3           by such centralized and unavoidable decisions.
- 4           • Our business customers want not only to make their own future choices but  
5           also to have a one-time valuation of the costs and benefits related to their  
6           share of the prior resource decisions PGE made on their behalf.
- 7           • Our residential customers want to have the Commission guide our future  
8           resource decisions in a market setting, using the costs and benefits related to  
9           their share of our prior resource decisions as a buffer while the suppliers and  
10          systems develop to make individualized resource decisions easy and reliable
- 11          • Our customers want building blocks from us, so that they can choose among  
12          the blocks and work with each block to add value to it and achieve a service  
13          that suits their needs – the result they want – not the generic needs of a  
14          “residential” or “commercial” customer.

15                 Change is not a future event we are forecasting. Change is a fact we are  
16          acknowledging. Because our customers have changed, we must change. Because  
17          we must change, regulation, also, must change. This filing, in response to our  
18          customers, reflects the change that has already occurred and lays the foundation  
19          for the future.

20          **Q. How does PGE propose that you, your customers, and the Commission**  
21          **accomplish this change?**

22          A. We propose to continue what SB 1149 itself suggests: evolutionary change. The  
23          legislation, the rules adopted so far, this filing – all are just a start. While we

1 know that our customers want to be customers, that is an aspiration, not a specific  
2 end-state. We also know that attempting to define the end-state at this moment  
3 and dictate the path is a recipe for certain disaster. What we are changing is too  
4 complex, and the variables too many, for even the most experienced of us to claim  
5 we know the way. We need to allow room – and time – for others to help us  
6 identify the questions, answer them, and then see the next layers of questions that  
7 those answers create. Some of the best answers, the best choices, are likely to  
8 come from companies that have never before participated in any part of the  
9 electric industry and from customers who never gave electricity a second thought.  
10 It is these sources that do not carry the baggage of pre-conceived notions that we  
11 “regulars” do. These players do not know that it can’t be done.

12 We believe that evolutionary change can actually be faster, and certainly  
13 more enduring, than more dramatic change. Throwing people off a figurative  
14 cliff, with no processes and suppliers to catch them, looks like progress while they  
15 are falling but, at the bottom, looks like a train wreck. Oregon can avoid that. If  
16 we all are thoughtful about our next steps, we can allow time and room for the  
17 answers to the questions we haven’t asked yet to emerge and can support a change  
18 that occurs by choice.

19 We know our aspiration. The processes include this filing, the Resource  
20 Plan, future rulemakings, and likely future filings. We have based our  
21 recommendations and proposals in this filing on two criteria that we believe are  
22 fundamental to success and will help guide us through the many decisions before  
23 us:

- 1           • Will this decision promote innovation?
- 2           • Will this decision preserve what is valuable in what we currently do unless
- 3           and until changed by a CUSTOMER decision?

4           In other words, does the proposal create opportunity, without compelling a

5           particular result?

6   **Q.    What do you recommend to promote innovation?**

7   A.    The single most important step we can take now to promote innovation is to

8           unbundle services and costs as thoroughly and as correctly as we can. Of course,

9           in the spirit of what we said above, we may not get this right the first time. So, we

10          should not only unbundle but should identify the processes by which we can

11          change our decisions after we experience the effects of them.

12 **Q.    Why is unbundling critical?**

13 A.    Unbundling is critical because, if we don't unbundle our services and products,

14          customers have to buy what we offer, not necessarily what they need or want.

15                 PGE currently offers a bundled service, supported by a bundled system of

16                 physical and intangible assets, people, and processes. This system is excellent at

17                 producing one service, at one price. Differentiation is much more difficult. Once

18                 PGE closed Trojan and had a gap between our long-term resources and our load,

19                 we could – and did – offer some electricity price and content choices for which

20                 we could make matching supply decisions. Even so, customers choosing these

21                 options had to pay for resources they were not necessarily using.

22                 Our goal is an open product and service system, to which PGE and many

23                 suppliers can attach other services and products to create whole products or

1 services for individuals, not just large groups such as “residential customers.”  
2 Whole products and services are whatever a customer needs to achieve the reason  
3 for purchasing the product or service in the first place. In other words, something  
4 is a whole product or service if it achieves the result a customer had in mind. This  
5 requires that suppliers discover a customer’s desired result and then assemble the  
6 products and services necessary to meet it. It is a systems approach and a process  
7 approach through which value is created or delivered by strategic removal,  
8 modification, or addition of pieces.

9 What we hope to achieve with unbundling is comparable to open network  
10 architecture or open source code software. If the last decades have taught us  
11 anything, it is that making the pieces visible and accessible to the economy as a  
12 whole unleashes creativity – and generally success for all, including the originator  
13 – far beyond what the originator could have accomplished on its own. Standards,  
14 protocols, and open architecture have driven the incredible pace of technological  
15 innovation we have seen. Openness is a foundation to innovation.

16 PGE would propose to unbundle even if SB 1149 did not exist. It is the  
17 natural step given what we have learned: that our customers have changed.

18 **Q. How should we judge the results of unbundling?**

19 A. PGE has unbundled our costs according to the Commission’s rules. But we invite  
20 everyone to help us determine whether our unbundling meets these criteria.

21 1. Are the pieces clear and well-defined? Nothing will stifle innovation more  
22 quickly than if we, our customers, and other suppliers who wish to create

1 whole products around electricity, cannot understand the pieces with which  
2 they must work.

3 2. Did we unbundle actual services and products, rather than just functions. It is  
4 much harder to imagine adding value to, or making a decision, about a  
5 function. Suppliers add value to other services and products; customers make  
6 decisions about services and products. Functions are how we think of  
7 ourselves internally.

8 3. Did we include terms and conditions with the services? Every service has  
9 terms and conditions. A critical term in a retail electricity service is risk.

- 10 • Who takes the risk that electricity is available?
- 11 • Who takes the risk that it is delivered?
- 12 • Who takes the risk regarding its price at the time the customer wants to  
13 use it?

14 To promote innovation, we must identify these terms and conditions and  
15 unbundle them to the extent possible.

16 4. Is interconnection easy? By this, we do not mean just physical  
17 interconnection. It is the information systems and other processes that support  
18 assembling, disassembling, and reassembling the pieces, among themselves or  
19 with new pieces that help promote innovation. We need to place as few  
20 restrictions as necessary on hooking the pieces together with other pieces as  
21 we can and not sacrifice reliability or safety.

1           5. Do the pieces carry all of their own costs, both direct and indirect, based on  
2           their terms and conditions? Doing this wrong will result in perverse  
3           incentives to favor one service or product over another.

4   **Q.    What does PGE unbundle in this filing?**

5   **A.**    We unbundle the following services:

6           1.       Distribution services. We have begun the work, which we were unable to  
7           complete in time for this filing, to define distribution services and  
8           establish all of the relevant terms and conditions. We plan to complete  
9           that work as soon as time permits.

10          2.       Generation/supply services. For this service, we have not just unbundled  
11          existing costs, but have developed several services, including two  
12          separated risk management services. The supply services are:

13           a.       Standard Energy Offer: this is a market-priced building block  
14           (monthly prices for on-peak and off-peak energy) that PGE can  
15           design into retail electricity services with other characteristics,  
16           such as flat annual rates or on-peak and off-peak seasonal rates,  
17           and which can form the basis for our residential and small non-  
18           residential customers to compare to various portfolio offers.

19           b.       Standard Offer: this, similarly, is a market-priced building block  
20           within which non-residential customers can choose four energy  
21           pricing options: (i) a daily index price, determined post-delivery;  
22           (ii) a monthly on-peak/off-peak price; (iii) monthly on-peak/off-  
23           peak prices fixed over a quarter; (iv) monthly on-peak/off-peak

1 prices fixed over a year. We designed this both to allow our  
2 customers some choice of price stability features and to provide a  
3 clear set of options against which electricity service suppliers  
4 (ESSs) could develop differentiated services.

5 c. Emergency Default Offer: a daily index price, determined post-  
6 delivery, plus a premium to cover the unpredictable nature of  
7 service under this rate.

8 The risk management services relate to our existing resource portfolio and  
9 short-term purchases that we may make in the future. We discuss these in  
10 more detail below.

11 We have begun, but have not necessarily finished, identifying all  
12 of the terms and conditions that should accompany these supply services.  
13 Again, we invite the participants in this case to help us finish this work.  
14 For example, should all of these services be for delivery into the PGE  
15 distribution system? In other words, should we arrange transmission  
16 services to our system and include the cost of that and transmission on our  
17 own system in the cost of these services? We have set the periods by  
18 which customers must give us notice to start and stop these services, but  
19 are they the right periods? Are these services subject to available supply  
20 on the market?

21 3. Transmission services: For transmission on PGE's transmission facilities,  
22 we propose that customers use our FERC open access transmission tariff  
23 (OATT). This includes relevant terms and conditions. The required

1 formation of a Regional Transmission Organization (RTO), however, and  
2 possible formation of an Independent Transmission Company (ITC) mean  
3 that this service and its terms and conditions could change.

4 4. Ancillary services. [I need something to say about this.]

5 5. Consumer services: We have unbundled these costs but this unbundling,  
6 required by SB 1149, strikes us as functional rather than a true service. If  
7 PGE has truly unbundled our services and products, each has customers  
8 and those customers need

9 a. to get questions about the service answered

10 b. a way to start and stop receiving the service

11 c. a way to pay for the service

12 Ultimately, these costs belong with each service. They are not somehow  
13 separate. We hope that others will join us in evaluating whether this  
14 separation makes sense or whether we should strive to include the costs of  
15 customer service with each of the unbundled services discussed above.

16 **Q. How do PGE's recommendations in this filing preserve what is valuable**  
17 **unless and until customers, individually or on an aggregated basis, decide**  
18 **something else is valuable?**

19 A. The rules the Commission adopted in September, and our implementation of those  
20 rules in this filing, accomplish this in two ways. The first relates to how we  
21 handle our current resource portfolio. The second relates to how we handle the  
22 gap between that resource portfolio and our customers' collective loads.

1           The rules permit us to place all of our resources, for all of our customers,  
2           in ongoing valuation effective October 1, 2001 and that is what we propose in this  
3           filing. This is important because it once and for all changes the nature of the  
4           relationship between our customers and these resources. The Commission's other  
5           decisions have placed our customers in an ownership position with respect to  
6           these resources. Placing them in ongoing valuation allows our customers to bear  
7           the costs and receive the benefits of the resources without necessarily buying the  
8           energy they produce. In other words, our customers need no longer take service  
9           from us to benefit from our resources. These resources become a risk  
10          management tool, which the Commission and our customers can evaluate as such.  
11          The resources no longer act as a barrier between our customers and market price  
12          information, while still acting as a check on how much of the market price  
13          customers actually experience.

14           In practical terms, ongoing valuation means that, on October 1, 2001, our  
15          customers have the same long-term hedge they presently have regardless from  
16          whom they obtain commodity energy. We manage these resources to maximize  
17          the value they produce as a hedge, earning a return on the investment made and  
18          bearing the risk that output or cost inputs will vary from what we expected. For  
19          now, this is adequate. We are proposing to set the fixed costs associated with  
20          these resources for three years at a time. This will preserve some of the historic  
21          risk assignment and ensure we have some incentive to control the fixed costs,  
22          while still updating the overall methodology annually.

1           With this transition, PGE, our customers, and the Commission can discuss  
2           and alter the composition of the hedge, through the Resource Plan and its  
3           successors, without changing its fundamental nature. We can also split the hedge,  
4           securing a one-time valuation for large non-residential customers. This places  
5           these customers in charge of identifying and obtaining such long-term hedges as  
6           they choose, without regard to our decisions. The Commission remains in charge  
7           of determining for residential and small non-residential customers, the amount of  
8           long-term hedge the Commission finds justified by market conditions as they  
9           change from time to time.

10           Nothing about restructuring is irrevocable until we adjust this hedge by  
11           selling existing resources to a 3<sup>rd</sup> party, to PGE, or between customer groups. We  
12           know that our customers, and the Commission, will approach these decisions  
13           carefully.

14           The second proposal reflected in this filing that secures current values  
15           until changed is how we propose to address reliability and price stability for 2002.  
16           Because PGE has fewer long-term resources than we have retail load, achieving  
17           reliability and price stability require an extra step. We could choose to fill our  
18           short position only for residential and small non-residential customers. But that  
19           choice did not meet our criteria of preserving what is valuable. It also seemed  
20           likely to create undue anxiety among our customer base.

21           Accordingly, we have been buying, and will continue to buy, electricity  
22           supplies to meet all of our service territory load during 2002. We plan to include  
23           these purchases in our ongoing valuation calculation for 2002, thus giving all

1 customers the benefit if our purchases are at less than the 2002 actual market price  
2 and recovering the cost if the market falls and the purchases we made to assure  
3 reliability are at prices higher than the then-current market price.

4 What we do after 2002 remains something of an open question. We have  
5 begun to develop a risk management product and process, by which direct access-  
6 eligible customers could choose whether to have us continue purchasing for  
7 reliability and short-term price stability. We call this the Purchase Acquisition  
8 Adjustment (PAA). We would accept notice from customers a year in advance  
9 that they did not wish us to plan for their needs in the following year. If a  
10 customer did not give us such a notice, that customer still is free to take service  
11 from an ESS at any time, consistent with the Standard Offer energy pricing option  
12 selected, but the customer carries along the costs or benefits of the PAA for that  
13 year. We have not completed developing this concept. Some troublesome issues  
14 remain, including how much of our short position to fill, even if no customers  
15 give us notice not to plan for them. We also need to design a way in which the  
16 Commission can have assurance that we made prudent purchases without auditing  
17 each and every one after the fact. The PAA surely is not the only mechanism by  
18 which we can preserve value for our customers until they make other choices.  
19 We hope to identify and discuss alternatives, as well as the unfinished parts of the  
20 PAA, as this case proceeds.

21 **Q. Please provide some perspective on the rate increases PGE is requesting**  
22 **through this filing.**

1 A. As we said above, this filing is a foundation. PGE has filed the case because of and  
2 for our customers. We acknowledge, however, that it is still a rate case and that,  
3 combined with our power cost filing of August, presents our customers with a  
4 substantial price increase.

5 The roots of this price increase are several.

6 **Supply and demand for electricity and natural gas.** Increased demands  
7 for power and natural gas within the WSCC have vastly outstripped increased  
8 supplies. The economic engine has been running hot. But uncertainty and a host  
9 of other factors inhibited resource development. That is changing, but not quickly  
10 enough to avert the effect on our costs and prices. Of the combined increase we  
11 are requesting in two pieces (1/1/01 and 10/1/01), \_\_% relates to power and fuel.

12 All of PGE's non-variable power cost expenses have risen less than 2%  
13 per year since the Commission's last full review of our cost of service, the UE 88  
14 rate case, processed in 1994 with a 1995/96 test period. This is less than inflation  
15 and it is unlikely PGE would have filed a rate case if not for the changes in  
16 variable power costs and, of course, the need to establish a foundation for SB  
17 1149 implementation.

18 **Supply and demand for people.** The booming economy has not just  
19 affected the price of electricity and natural gas. It has affected the price of human  
20 resources. We actually prefer to think of our employees as our talent because the  
21 word "resources" implies a fungibility that does not exist. People are not all the  
22 same. In a service business, people are the critical link between the physical  
23 assets, technology, and processes a company has, and the result that company's

1 customers want. We can never anticipate enough contingencies, and build  
2 systems around them, to make people irrelevant to the certainty and quality of  
3 result.

4 The new story on people is there are not enough. PGE faces stiff  
5 competition for new employees, particularly in areas such as information  
6 technology and customer service representatives. We also need to increase the  
7 diversity of our employee population, to adapt to the increasing diversity in our  
8 service territory and ensure that we achieve and keep the competitive advantages  
9 available to a company that truly embraces the value of diversity.

10 To attract new people and retain those we have, PGE needs continually to  
11 update our compensation tools. We may need new tools to entice older  
12 employees to stay, on their terms, rather than retire. What is most critical is that  
13 we stay close to the market in which we must compete for talent. Falling behind  
14 the market could jeopardize our ability to deliver what our customers want and, at  
15 worst, could threaten core customer values around safety and reliability.

16 The other story on people is not as new but is, perhaps, more relevant than  
17 before. As should be apparent from our discussion above, we operate in times of  
18 great change. This change profoundly affects our employees. The days of  
19 knowing a job and having that job continue unaltered year after year are long  
20 gone. Uncertainty and distractions abound. Managing effectively, to produce  
21 results, now requires much more extensive goal-setting and much more  
22 communication than ever before, accompanied by compensation tools.

1 Over the last few years, PGE has adopted a scorecard system for  
2 identifying the most critical results for a given year. As President and CEO, I  
3 prepare a scorecard for the entire organization. Each of my officers then prepares  
4 one, detailing the results for which they are responsible to support the overall  
5 goals. Then, each manager and supervisor under each officer prepares one, again  
6 identifying aligned results. In some areas of the company, each individual  
7 contributor in a work group prepares a scorecard. We use these scorecards as the  
8 basis for compensation decisions, both guaranteed compensation and pay-at-risk.

9 Smart managers know that you cannot make people do the right things.  
10 The best a company can do is attempt to attract the right people and give them  
11 what they need to make it happen. Of the things employees need to make it  
12 happen, direction is probably the most important. This is what scorecards, and  
13 PGE's incentive/pay-at-risk program, is all about

14 **Customer Demands.** We discussed this briefly above and PGE Exhibit  
15 &&, Customer Service, discusses the new demands our customers have of us in  
16 more detail. Meeting these demands at times requires the sacrifice of economy of  
17 scale.

18 **Technology.** The last five years have brought an unprecedented explosion  
19 in information technology. This explosion affects us everyday in our personal  
20 and working lives. Being an electric utility has not granted PGE immunity from  
21 this explosion and its affects. We must meet the higher expectations of our  
22 customers and our employees that relate to the effective deployment of

1 information technology. Although still a relatively minor part of our costs, these  
2 information technology costs have grown [by what %] since our last rate case.

3 The sum of these forces is higher costs. We believe, however, that value  
4 has risen more quickly even than costs. We do not stop often enough to consider  
5 value. Value is hard to measure. We think we can quantify cost, although if we  
6 attempt to be truly comprehensive – such as our attempts to quantify the  
7 environmental costs of various actions – we often fail. Value, in contrast, is  
8 qualitative. Cost can be seen; value must be experienced. But value is where we  
9 need to go because that is what customers want.

10 In the next few years, both cost and value will challenge our regulatory  
11 processes significantly.

12 **Q. What are the effects on economic regulation of all of the changes and drivers**  
13 **you have discussed?**

14 A. This is still primarily a cost of service case but the weaknesses of this decades-old  
15 methodology are becoming painfully evident and, for some unbundled services or  
16 cost components of those services, we suggest other approaches.

17 The roots of cost of service, and the era in which it developed, define its  
18 weaknesses. Cost of service functions best in a stable world and in a world where  
19 the utility controls many of the inputs. In the early part of the 20<sup>th</sup> century,  
20 electric utilities were, by and large, price setters. Compared to most companies,  
21 they were large and had significant influence in all of the markets in which they  
22 bought what they needed. Of course, fewer markets existed then too. All

1 electricity, wholesale and retail, was regulated, as were many of the inputs such as  
2 natural gas.

3 The pace of technological innovation was slow and generally it was a  
4 fairly mechanical exercise to compare current costs to the utility's last approved  
5 costs to determine if the increases were justified. During much of the 1970s and  
6 1980s, the primary change from rate case to rate case was inflation – a force that  
7 was explainable, if not entirely acceptable or satisfactory. In this context, both  
8 regulators and utilities could have confidence that, except in times of rampant  
9 inflation, rates set today would probably endure for several years. Further easing  
10 the regulatory burden was that few utilities engaged in services, regulated or  
11 otherwise, other than the provision of the bundled electric service.

12 None of this is true any longer. Of the primary fuels for electric  
13 generation, only nuclear fuel is still regulated [is this true?]. We purchase in  
14 national, even continental, markets for fuel. We buy in national and world  
15 markets for materials and in national or regional markets for talent. We compete  
16 for capital in a world-wide market. Few would dispute that the capital markets  
17 have changed significantly since 1994, when the Commission last established our  
18 cost of capital. Utilities, certainly not PGE, control none of these markets. We  
19 are price takers, not price setters.

20 These changes, the driving market forces, challenge the premises of cost  
21 of service. Costs are not stable. Markets dictate the changes, not inflation.  
22 Organizational, process, and other changes challenge our ability to trace from one  
23 set of approved costs to a proposed set some years later. And neither we nor the

1 Commission can have confidence that the costs approved will remain a good  
2 reflection of the cost of service for months, let alone years, in the future.

3 Compounding the difficulty is that many utilities, including PGE, want to expand  
4 their roles with customers, offering services beyond the pieces of the previously  
5 bundled service and competing to obtain customers for these new services in the  
6 same way as any other business.

7 **Q. How do you propose to address the weaknesses in cost of service?**

8 A. We are proposing some new guidelines for use in this case. First, we propose to  
9 price our cost inputs according to market, if a market exists. This is certainly the  
10 case for electricity, natural gas, and labor. Moreover, for electricity and natural  
11 gas, we propose to re-price to market annually, and to do so a relatively short time  
12 in advance of the year in which we propose our forecast be in place. We believe  
13 this strikes an acceptable balance between price stability and the accuracy of our  
14 market forecasting skills. For labor, we are comfortable leaving the forecast in  
15 place for an indefinite period as long as the Commission bases its approval on  
16 market.

17 Second, if no market exists, we will need to continue pricing cost inputs  
18 and services administratively. Even in these circumstances, however, PGE would  
19 like to begin identifying ways to improve administrative pricing and overcome  
20 some of the weaknesses of cost of service. The best way to do this is to arrange  
21 competition, either between suppliers of a particular service or between  
22 alternative services from one supplier. How this could work, for example, is that  
23 PGE might offer two or more choices for a given service, one priced at cost and

1 the others priced on more of a value basis. Risk management provides a good  
2 example. We have three choices for pricing risk management:

3 1. PGE buys insurance against a given risk and customers pay the cost of the  
4 insurance. The “Weatherproof Bill” we developed recently is an example  
5 of this type of offer. Customers pay a bill based on “normal” weather plus  
6 a premium to a third party, who provides the traditional insurance function  
7 of assembling a large enough risk pool to balance the effects of warmer or  
8 cooler than normal weather.

9 2. PGE simply incur the costs of a given risk as we realize that risk and pass  
10 these costs through to customers. This is, essentially, how regulation  
11 handled the market price risk of natural gas and oil [was oil regulated?  
12 Until when?] as they deregulated over the last several decades. Fuel  
13 adjustment clauses transfer all of the risk to customers so that they get the  
14 benefit of lower prices when the contingent event does not occur but pay  
15 for the event when it does.

16 3. PGE proposes to assume the risk at a price that we believe adequately  
17 compensates us for the value provided.

18 As long as customers can choose, not all choices must be based strictly on cost.

19 We do not have all of the answers here, or even complete proposals. But  
20 we have described where we would like to go. We want to work with our  
21 customers and the Commission to develop these thoughts.

22 Third, we need to ensure that the design of our prices makes sense for the  
23 service being priced. The price design that made sense for our previously bundled

1 service may no longer make sense for one of more of the pieces. PGE's proposals  
2 generally attempt to:

- 3 • Retain variable (per kWh) pricing makes sense for generation/supply  
4 services. You use it, you pay. You don't use it, you don't pay.
- 5 • Apply fixed pricing to risk management services. For example, our  
6 ongoing valuation methodology will pass the costs or benefits of this  
7 hedge through to customers on a per kWh basis but we will true-up to  
8 the exact amount regardless whether loads are higher or lower than  
9 forecast when we designed the per-kWh charge or credit.
- 10 • Allow evolution of distribution service pricing. Variable pricing does  
11 not make really make sense for distribution services. This capability  
12 service is much more like local dial tone or cable services, both of  
13 which customers buy at fixed rates per month. Nonetheless, we  
14 recognize and support the important public policy objectives of  
15 encouraging energy efficiency and preventing price shifts within the  
16 residential and small non-residential customer classes that variable  
17 pricing achieves. Accordingly, we propose to establish fixed, demand-  
18 based prices for larger non-residential customers and design a revenue  
19 cap for residential and small no-residential customers. We have not  
20 yet developed the parameters for the revenue cap and will update this  
21 filing as we complete this work. We would also like to explore with  
22 our customers and the Commission offering residential and small non-  
23 residential customers a choice of a fixed rate distribution service.

1 Fourth and last, we suggest that the Commission regulate the separation  
2 between regulated and competitive services by requiring that we unbundle  
3 correctly and thoroughly account for costs of providing these services as we  
4 develop and offer them. We do not support restrictions that require us to form  
5 separate companies to offer such services (except for the previously monopoly  
6 service of retail electric commodity supply) or that preclude us from offering  
7 convenient service to customers. We prefer the telecommunications model and,  
8 while it is not perhaps a perfect path to the future, it meets the test of promoting  
9 innovation.

10 **Q. What do you recommend the Commission do with this filing if SB 1149 is**  
11 **delayed or repealed?**

12 A. We recommend that the Commission adopts as many of our proposals as it has  
13 authority to adopt. Based on the natural gas industry, we believe the Commission has  
14 authority to proceed with direct access. While the SB 1149 design for the public  
15 purpose charge may not be replicable without specific legislation, we likely can  
16 achieve the intent of that charge to provide for energy efficiency and investment in  
17 renewable energy resources in other ways. Allowing PGE to expense our energy  
18 efficiency expenditures as we incur them is an example of one such way. This  
19 treatment allows us to increase expenditures without concern that we are creating a  
20 stranded asset the later recovery of which is uncertain.

21 **Q. How is PGE presenting this case?**

1 A. We have seventeen sets of testimony and exhibits to help the Commission and our  
2 customers understand our costs, proposals, and recommendations. In addition to  
3 this PGE Exhibit 100, these are:

4 **PGE Exhibit 200, Revenue Requirement**, in which Jim Barnes, [insert title],  
5 presents PGE's bundled 2002 revenue requirement, compares it to our 1996  
6 approved revenue requirement, and explains certain components of this revenue  
7 requirement not covered elsewhere.

8 **PGE Exhibit 300, Power Supply**, in which Walt Pollock, [insert title], and  
9 Marlene Huntsinger, [insert title], present PGE's currently forecasted variable  
10 power costs and PGE's forecasted generation O&M costs, and explain how we  
11 propose to provide our customers with supply and risk management services post-  
12 October 1, 2001.

13 **PGE Exhibit 400, Delivery Services**, in which Steve Hawke, [insert title], and  
14 Joe McArthur, [insert title], present and support our 2002 forecasted costs for  
15 distribution and transmission services.

16 **PGE Exhibit 500, Customer Service**, in which Chris Ryder, [insert title], and  
17 Dave Carboneau, [insert title], present and support our 2002 forecasted costs for  
18 learning about our customers' needs, designing and developing regulated services  
19 to meet those needs, and delivering those regulated services.

20 **PGE Exhibit 600, Corporate Allocations**, in which Jim Piro, [insert title], and  
21 Mark Lindsey, [insert title], present and support the Enron direct charges and  
22 allocations that we forecast for 2002.

1       **PGE Exhibit 700, Corporate Support**, in which Kirk Stevens, [insert title],  
2       presents and supports our forecasted 2002 costs for various support functions,  
3       such as Legal, Rates and Regulatory Affairs, and Corporate Communications.

4       **PGE Exhibit 800, Information Technology**, in which Tom Mathews, [insert  
5       title], and Mel Greenberg, [insert title], present and support PGE's 2002  
6       forecasted costs for information technology.

7       **PGE Exhibit 900, Total Compensation**, in which Arleen Barnett, [insert title],  
8       and Joyce Bell, [insert title], present and support PGE's 2002 forecasted costs for  
9       total compensation, including cash compensation and benefits, or non-cash  
10      compensation.

11      **PGE Exhibit 1000, Decommissioning**, in which Mike Lackey, [insert title], and  
12      Patrick Hager, [insert title], update PGE's decommissioning cost estimate and  
13      recommend that the Commission continue funding of the Nuclear  
14      Decommissioning Trust as current levels.

15      **PGE Exhibit 1100, Cost of Capital**, in which Patrick Hager, [insert title], and  
16      Bill Valach, [insert title], present and support PGE's recommended 2002 cost of  
17      capital.

18      **PGE Exhibit 1200, CAPM and Market Volatility**, in which Dr. Charles Nelson,  
19      [a professor at UW? – snippet here about who he is], explains his belief that the  
20      Capital Asset Pricing Model (CAPM) [fill in].

21      **PGE Exhibit 1300, Load Forecast**, in which Ham Nguyen, {insert title},  
22      presents and supports PGE's 2002 service territory load forecast.

1       **PGE Exhibit 1400, BPA Subscription**, in which Lyn Williams, [insert title],  
2       presents the residential and small farm benefits PGE estimates we will receive  
3       from the Bonneville Power Administration under the Subscription program and  
4       explains the current state of that process.

5       **PGE Exhibit 1500, Overview, Unbundled Services/Costs**, in which Gary  
6       Young, [insert title], and Jay Tinker, [insert title], explain the methodology PGE  
7       used to unbundle costs into specific services and present the results of that  
8       unbundling.

9       **PGE Exhibit 1600, Pricing**, in which Randy Dahlgren, [insert title], Dara  
10      Cardwell, [insert title], and Doug Kuns, [insert title], present and explain PGE's  
11      recommended prices for this filing.

12      **PGE Exhibit 1700, Competitive Transition Mechanism**, in which Jim Piro  
13      presents and explains PGE's proposed ongoing valuation methodology.

14      **Q. Do you have any recommendations for how the Commission should process**  
15      **this filing?**

16      A. Yes. This filing has all of the complexity of any rate case filing, compounded  
17      several times by the changes in the world around us and the specific changes  
18      mandated by SB 1149. What will NOT be useful is to process this case as any  
19      other litigation, engaging in discovery, competing rounds of testimony, and  
20      briefing. The practices and tactics of litigation will not help the Commission, our  
21      customers, or PGE jointly develop what we must to successfully set a foundation  
22      for the future.

