

ITEM NO. 1

**PUBLIC UTILITY COMMISSION OF OREGON  
STAFF REPORT  
PUBLIC MEETING DATE: September 23, 2003**

**REGULAR**   X   **CONSENT**        **EFFECTIVE DATE**       October 1, 2002      

**DATE:** September 15, 2003

**TO:** Lee Sparling through Ed Busch and Jack Breen III

**FROM:** Deborah Garcia

**SUBJECT:** PORTLAND GENERAL ELECTRIC: (Docket No. UM 1040) Requests reauthorization for deferral of certain advertising costs for later ratemaking treatment and adoption of a related stipulation.

**STAFF RECOMMENDATION:**

I recommend that the Commission adopt the attached stipulation<sup>1</sup>; and approve Portland General Electric Company's application to defer amounts spent on Category A advertising in excess of the final amount approved in UE 115, for the 12 months beginning October 1, 2002, with reporting requirements. Approval will be for accounting purposes only and does not constitute approval for ratemaking purposes.

**BACKGROUND:**

Portland General Electric's (PGE or Company) last general rate case, Docket UE 115, was filed as a result of electric industry restructuring legislation that in part directed investor-owned utilities, such as PGE, to allow nonresidential customers direct access to purchase electricity, and to provide a portfolio of rate options to residential and small nonresidential customers. During the UE 115 proceeding, Staff recognized that PGE would have short-term Category A advertising<sup>2</sup> expense associated with the implementation of electric restructuring (and ongoing customer education responsibilities) that would drive Category A advertising expense higher than the level of expense normally incurred in the past and higher than the amount presumed to be just and reasonable by rule.<sup>3</sup> However, due to the uncertainty of electric restructuring

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<sup>1</sup> See Attachment 1 for a copy of the explanatory brief and stipulation entered into by PGE, CUB, and PUC Staff.

<sup>2</sup> Category A advertising is defined in OAR 860-026-0022 (2)(a) Presumptions of Reasonableness of Advertising Expenses in Utility Rate Cases Category "A" – Energy efficiency or conservation advertising expenses that do not relate to a Commission-approved program, utility service advertising expenses, and utility information advertising expenses;

<sup>3</sup> OAR 860-026-0022 (3)(a) Presumptions of Reasonableness of Advertising Expenses in Utility Rate Cases Advertising expenses in Category "A" are presumed to be just and reasonable in a rate proceeding to the extent that

activities, it was unclear how much additional expense could be considered prudent and how long a higher than normal level of spending would be necessary. If, until the next rate case, PGE were allowed to embed into base rates a specific amount of additional expense annually, earmarked for Category A expenditures, there was no guarantee that the money would be spent for that purpose. Because the Commission cannot engage in retroactive ratemaking (absent deferral accounting), the Commission could not retrieve for customers the difference between the Category A expense budgeted into rates and what was actually spent.

A settlement of the issue was reached in UE 115 and added to the revenue requirement stipulation the Commission adopted in Order No. 01-777. The stipulation clause (the UE 115 stipulation) allowed PGE to defer annually Category A expense above the level presumed just and reasonable if PGE agreed to an audit for proper categorization and prudence of all Category A expense each year. The results of Staff's audit would be available for review before the Commission decided how much of the deferral to amortize into rates. Normally, an audit of this expense would not be conducted on an annual basis because the expense is already embedded in rates. The settlement protected customers by ensuring that they pay only prudently incurred Category A advertising expenses.<sup>4</sup>

For the first audit period, October 1, 2001 through September 30, 2002, PGE filed an application under ORS 757.259 and OAR 860-027-0300 that asked, in accordance with the UE 115 stipulation, for approval by the Commission to defer the Category A expense that exceeded the amount embedded in rates. The Commission first considered PGE's request during the December 11, 2001 Public Meeting at which Bob Jenks of the Citizens' Utility Board (CUB) raised concerns about the amount of PGE's proposed deferral and whether the UE 115 stipulation was too open-ended. The Commission postponed a decision on the application to allow for further review.

Subsequently, PGE, CUB, and Staff negotiated a stipulation (the 2001 UM 1040 stipulation) that allowed PGE to defer all additional Category A advertising expense for the 12 month period beginning October 1, 2001, but capped the amount that PGE could request be amortized into rates at \$1,920,973. This stipulation limited total Category A expense for the 12-month period to \$3.8 million -- less than the \$4.1 million PGE originally requested in its UE 115 filing. The Commission approved the deferral request and adopted the 2001 UM 1040 stipulation by Order No. 02-088.

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expenses are twelve and one-half hundredths of 1 percent (0.125 percent) or less of the gross retail operating revenues determined in that proceeding;

<sup>4</sup> See Attachment 2, Staff's audit, for additional details.

## **DISCUSSION:**

### Application for Authorization of Category A Expense Deferral

On September 30, 2002, PGE filed an application under ORS 757.259 and OAR 860-027-0300 asking, in accordance with the UE 115 stipulation, for approval by the Commission to reauthorize deferral of Category A advertising that exceeds the amount currently allowed in rates.

### Proposed Accounting

PGE proposes to record the deferral as a regulatory asset in FERC Account 182.3 crediting FERC Account 407.4 (Regulatory Credit Amortization). When deferred costs are authorized by this Commission to be recovered through rates, PGE will debit FERC Account 407.3 (Regulatory Debit Amortization) and credit FERC Account 182.3.

After receipt of the above application, the other UM 1040 Parties, CUB and Industrial Customers of Northwest Utilities (ICNU), agreed to consider a second year UM 1040 stipulation (the 2002 UM 1040 stipulation) after Staff's required audit of the 1<sup>st</sup> year Category A expense (the 2001-02 audit) was complete. PGE and Staff agreed that delay of Commission approval for this subsequent application would not harm PGE as approval of a request to defer expense is retroactive to the date of the filing.

### Staff Audit of 1st Year (Oct. 2001 – Sept. 2002) Category A expense

Staff conducted a thorough audit of the 2001-02 Category A expense, the results of which are in Attachment 2 of this memo. PGE reported expense eligible for deferral for the 12 month period of \$936,234, or \$984,739 less than the stipulated cap of \$1,920,973. Staff recommends that the incremental Category A advertising expense be reduced by \$66,250 and the Commission should consider \$869,984 as the maximum amount of Category A advertising eligible for later amortization into rates.

### 2002 UM 1040 Stipulation

The UM 1040 parties held a teleconference on August 15, 2003 to discuss whether a new stipulation related to the 2002 application for deferral was necessary. It was generally agreed that the concerns raised by CUB the year before were still valid and that a new stipulation was the best solution. CUB suggested, and the other parties agreed, that the cap on the amount of deferred expense for which PGE should be allowed to request amortization should be lowered to the amount of expense PGE actually incurred the previous year, plus some amount for inflation. PGE, CUB, and

Staff settled on a cap of \$1 million. During the teleconference, ICNU did not agree or disagree on the amount of the cap, or whether to sign the stipulation, but did agree to subsequently notify the other parties of its decisions. ICNU notified the parties by e-mail on September 2, 2003 that it would not sign the stipulation, but would not oppose it. ICNU also stated that it plans to provide comments on the stipulation and deferral during or before the September 23<sup>rd</sup> Public Meeting.

Staff recommends that the Commission reauthorize the deferral of excess Category A advertising expenses for the period October 2002 – September 2003. However, before any amortization of that balance is allowed, Staff will perform a thorough audit of those expenditures. CUB, ICNU, and other parties may also participate in the audit. Staff also recommends the Commission direct PGE to continue making quarterly reports providing detail and documentation of all Category A expenses, including those in base rates.

**PROPOSED COMMISSION MOTION:**

Adopt the stipulation attached to Staff's Public Meeting Report as Attachment 1, and allow Portland General Electric's application to defer amounts spent on Category A advertising in excess of the final amount approved in UE 115 be approved for the 12 months beginning October 1, 2002. The Company is further directed to continue to file with the Commission, within 45 days after the end of each quarter, a report documenting all Category A expenses.

Approval will be for accounting purposes only, and does not constitute approval for ratemaking purposes.

## **UM 1040 Staff Audit of Category A advertising for the period of 10/01/01 through 9/30/02**

The purpose of this audit is to ensure that the expense incurred for the above period is allocated to the proper advertising category and is prudent.

### **Background**

Advertising category "A" is defined by rule<sup>5</sup> and the level of Category A expense presumed to be just and reasonable in a utility rate case is prescribed by rule.<sup>6</sup> In PGE's last general rate case, UE 115 (final Order No. 01-777), the Commission allowed Category A expense of \$1,879,027, or twelve and one-half hundredths of 1 percent (0.125 percent) of the gross operating revenues as determined in the preceding, to be embedded in rates. During the UE 115 proceeding, Staff recognized that the Company would have short-term advertising expense, associated with the implementation of electric restructuring, that would drive advertising expense higher than the level of expense normally incurred in the past and higher than the amount presumed to be just and reasonable by rule. At Staff's suggestion, the following settlement of the issue was reached: PGE would be allowed to defer the actual incurred Category A expense that exceeded the annual amount allowed in rates, if PGE agreed to an audit of all Category A expense each year to confirm the expense was properly allocated as Category A expense and was prudent. The results of Staff's audit would be available for review before the Commission decided how much of the deferral to amortize into rates. Because an audit of this expense is not usually conducted on an annual basis as the expense is embedded in rates, this settlement protected customers by ensuring that they pay only prudently incurred expenses. The settlement was memorialized in the revenue requirement stipulation adopted in Order 01-777.

At the December 11, 2001 Public Meeting, Staff recommended that the Commission approve PGE's above-mentioned deferral application recognizing that any amount deferred would be subject to audit for proper categorization and prudence and would not automatically be amortized into future rates. Because of concerns raised by Bob Jenks of the Citizens' Utility Board (CUB) the Commission postponed consideration of the application to allow further review. Mr. Jenks was concerned that PGE was proposing to spend more, between the amount embedded in rates and the estimated amount of the deferral account, than the \$4.1 million PGE originally requested in the UE 115 rate case.

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<sup>5</sup> OAR 860-026-0022 (2)(a) Presumptions of Reasonableness of Advertising Expenses in Utility Rate Cases Category "A" – Energy efficiency or conservation advertising expenses that do not relate to a Commission-approved program, utility service advertising expenses, and utility information advertising expenses;

<sup>6</sup>OAR 860-026-0022 (3)(a) Presumptions of Reasonableness of Advertising Expenses in Utility Rate Cases Advertising expenses in Category "A" are presumed to be just and reasonable in a rate proceeding to the extent that expenses are twelve and one-half hundredths of 1 percent (0.125 percent) or less of the gross retail operating revenues determined in that proceeding;

He also felt that the stipulation, as written and adopted in Order No. 01-777, could conceivably give PGE a "blank check" regarding the amount of Category A advertising that could eventually be amortized into rates. Mr. Jenks proposed that the Commission qualify approval of the deferral account application by capping the amount of expense that could be deferred.

On December 27, 2001, PGE, CUB, and Staff held a conference call to discuss the filing and to explore whether a settlement of the issues could be negotiated. An agreement was reached that satisfied the concerns of Staff, CUB, and the Company. In the stipulation, the parties agreed that PGE could defer all Category A advertising expense for the 12-month period beginning October 1, 2001. At the end of the period, PGE would provide, to Staff and other interested parties, all necessary materials for a thorough audit to ensure that the expenses were properly categorized as Category A expense and were prudent. After the Staff audit was complete, PGE would be able to request in a future rate making proceeding that the deferral be amortized into rates, with the following caveat: PGE will not seek to amortize into rates more than \$1,920,973 of the deferred amount. The cap on the amortization into rates of deferred Category A expense ensures that this 12-month period of Category A expense is limited to \$3.8 million which is less than the amount PGE originally requested in its UE 115 case. The stipulation also required PGE to provide quarterly reports of its actual Category A expenditures.

At the January 29, 2002 Public Meeting, the Commission adopted the second stipulation and memorialized it in Order No. 02-088.

### **Discussion**

PGE has filed the required quarterly reports in a timely manner. Throughout this first year, PGE reported that the methods used by employees to allocate both labor and non-labor expense were constantly scrutinized and fine-tuned to be as accurate as possible. This process required PGE to make changes to some of the line items in subsequent quarterly reports. Staff examined the reports and found that the reasons for the changes have been thoroughly explained, are documented, and are reasonable. The final spreadsheet figures used in Staff's report are from Attachment 003-C of PGE's January 27, 2003, 4<sup>th</sup> Supplemental response to Staff Data Request #3, hereinafter referred to as Attachment 003-C.

Staff conducted a thorough audit of all of PGE's Category A advertising as well as investigated the labor associated with the projects. Staff analyzed all of PGE's Category A advertising collateral<sup>7</sup> to ensure that it was properly classified based on the definitions of advertising categories specified by OAR 860-026-0022 (2). Staff agrees with the majority of the PGE's classification and commends the Company for its attention to

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<sup>7</sup> Collateral is defined as all actual ad copy (for printed advertising) or scripts (for TV or radio advertising.)

detail. Staff's audit consisted of a detailed examination of every Category A advertisement; the expense associated with each advertisement, and an analysis of general labor costs associated with the advertising. Staff also conducted an even more detailed analysis of specific line items that were chosen on an informal random basis. For that portion of the audit, Staff went to PGE's office and interviewed the employees and managers associated with the production of the advertising. During the entire audit, PGE did an excellent job of responding to Staff's questions and provided all requested additional information in a timely fashion, which was very helpful to Staff's process.

PGE reported in Attachment 003-C a total Category A advertising expense for October 2001 through September 2002, of \$2,815,261. Broken down this total consists of \$1,879,027 already embedded in current rates and incremental \$936,234 eligible for Commission consideration to amortize in rates under the stipulation adopted in Order 02-088. The amount eligible for consideration is \$984,739 less than the Category A deferred expense cap that was specified in the stipulation.

### **Audit Results**

Staff identified the following Attachment 003-C line items as expense that cannot be legitimately classified as Category A expense and recommends that the Commission disallow the expense at such time PGE seeks to amortize the expense into rates.

Line 1 Miscellaneous Labor	\$17,068
Line 5 Business Update	\$2,436
Line 8 Electron Run Races	\$45,912
Line 79 Newberg Chamber Ad	\$435
Line 92 Tualatin Chamber Ad	\$399
Total Staff recommended disallowance	\$66,250

#### Line 1 Miscellaneous Labor:

On May 29, 2003, PGE provided Staff with a list of the types of jobs and the percentage of each employee's time allocated to Category A advertising. Staff noticed that the Line 1 total in the May 29<sup>th</sup> response is \$152,287, or \$34,000 less than the Attachment 003-C total of \$186,382. PGE explained that the total differences are labor loadings associated with the activities in Line 1. Staff believes that the portion of these labor loadings that are related to disallowed labor costs should also be disallowed.

Based on the job descriptions, PGE did not sufficiently demonstrate that the Specialist (Production) engaged in only Category A during the deferral period. However, since the deferral period, PGE has improved the timekeeping practices related to this activity and has recorded, for the period January through July 2003, that 75% of this job is related to

Category A activity. PGE asserts the timekeeping has changed rather than the employee's activities. Therefore, Staff recommends that 25% of this item be disallowed.

Again, based on the job descriptions, Staff, believes that the Supervisor (Sponsorships) expense should be disallowed because the Category A expense definition does not include sponsorship.

	Requested	Recommended Disallowance
Total labor loading	\$34,000	\$3,094
Specialist (Production)	\$50,899	\$12,725
Supervisor (Sponsorships)	\$1,249	\$1,249
Totals	\$86,148	\$17,068

#### Line 5 Business Update

Staff believes that one-third of the space of the Business Updates (at a cost of \$2,436) cannot be accurately categorized as Category A expense.

#### Line 8 Electron Run Races

Although Staff believes that the Electron Run Races are a valuable learning tool for students, the \$45,912 expense cannot be accurately categorized as Category A expense.

#### Lines 79 and 92 Newberg and Tualatin Chamber Ads

The ads in these publications (expense of \$435 and \$399, respectively) function as financial support that enables the organizations to publish directories. Community outreach is not a Category A expense.

### **Final Recommendation**

Staff recommends that the incremental Category A advertising expense of \$936,234 that PGE reported in Attachment 003-C be reduced by \$66,250. Therefore, the Commission should consider \$869,984 as the maximum amount of Category A advertising eligible to be amortized into rates.