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November 10, 2005

Via Electronic Filing and U.S. Mail

Oregon Public Utility Commission
Attention: Filing Center
PO Box 2148
Salem OR 97308-2148

Re: In the Matter of UTILITY REFORM PROJECT and KEN LEWIS
Application for Deferred Accounting
OPUC Docket No. UM 1224

Attention Filing Center:

Enclosed for filing in the above-captioned docket is Portland General Electric's Comments Regarding Utility Reform Project's Application for Deferred Accounting. This document is being filed by electronic mail with the Filing Center.

An extra copy of this cover letter is enclosed. Please date stamp the extra copy and return it to me in the envelope provided.

Thank you in advance for your assistance.

Sincerely,

/s/ DOUGLAS C. TINGEY

DCT:am

cc: UM 1224 Service List

Enclosure

BEFORE THE PUBLIC UTILITY COMMISSION

OF OREGON

UM 1224

In the Matter of UTILITY REFORM PROJECT and KEN LEWIS Application for Deferred Accounting	**PORTLAND GENERAL ELECTRIC COMPANY'S COMMENTS ON APPLICATION FOR DEFERRED ACCOUNTING**

I. INTRODUCTION

The Utility Reform Project's and Ken Lewis's (collectively "URP") Application for Deferred Accounting ("URP's Application") and complaint ("Complaint") suggest that this proceeding should be about Senate Bill 408 ("SB 408").[1] URP is wrong. URP has filed for deferred accounting under the general deferral statute—ORS 757.259—not SB 408. The issues before the Commission are therefore twofold: (1) Does this Application meet the legal requirements of ORS 757.259; and, if so, (2) should the Commission exercise its discretion to grant the Application?[2]

URP's Application fails ORS 757.259's legal requirements for at least three reasons: (1) the deferred accounting statute does not authorize URP's combination of a deferred accounting application and general rate complaint; (2) URP's Application fails to satisfy the specific statutory requirements of ORS 757.259(2)(e); and (3) URP's Application does not seek to defer an "an identifiable expense or revenue" as the law requires. Nor does the Application warrant the exercise of the Commission's discretion. URP's Application creates significant risk for customers (*i.e.*, potential loss of accelerated depreciation tax deductions), provides no benefit

[1] These Comments concern URP's Application. PGE's Motion to Dismiss filed today in the companion docket UM 1226 responds to the Complaint.

[2] *See* UM 1071, Order No. 04-108 at 8.

that SB 408 cannot capture, and will impose unduly burdensome regulatory demands on the Commission.

The Commission should reject URP's Application at this stage in the proceeding. In the event the Commission declines to deny URP's Application without further proceedings, PGE requests a hearing under ORS 757.259(2) and asks that the Commission conduct a contested case proceeding on URP's Application.

II. URP'S FILINGS

Although URP has filed two separate papers—the Complaint and Application—the basis for both submissions is the same. URP complains and seeks deferred accounting because PGE's current rates allegedly include a tax expense that is not paid to any governmental entity. Thus, the Complaint alleges that:

> PGE's rates, since September 2, 2005 [the effective date of SB 408], and continuing to the present, are not just and reasonable and are in violation of SB 408 (2005) because they contain approximately $92.6 million in annual charges for state and federal income taxes that are not being paid to any government.

Complaint at 1.

The reason URP offers for deferred accounting is the same:

> Deferred accounting is requested, because PGE is charging ratepayers approximately $92.6 million annually for 'federal income taxes' and 'state income taxes' that is not being paid to either government. The Commission has concluded that, as of the effective date of SB 408, such charges are not fair, just and reasonable.

Application, ¶ 2.

The Complaint and Application fit together. The Complaint appears to seek a prospective change in PGE's rates. Complaint, ¶ 6. The Deferred Accounting Application seeks to lock in that rate change as of the date of the filing. Applications, ¶ 5.

III. URP'S APPLICATION LACKS LEGAL AUTHORITY

The Legislature did not intend for the Commission or parties to use deferred accounting to render current rates interim or to refund revenues without any lawful basis. URP has tried this strategy before, and the Commission has rejected it.

In UE 76, URP combined a complaint under ORS 756.500 with an application for deferred accounting based upon alleged unlawful late fee charges. Order No. 92-1128 at 1-2. The complaint and deferral application were consolidated because the "issues relating to the deferral are largely the same as the issues in the complaint case." *Id.* at 2. The Commission found that a prospective rate adjustment was appropriate to recognize the additional late fee revenues. *Id.* at 7-8. Because the amount of the adjustment was small (about $300,000 per year), the Commission established, on a prospective basis from the date of the Commission order, a deferral for the adjustment amount to minimize the frequency of rate changes. *Id.* However, the Commission rejected a retroactive rate adjustment effective upon the filing of the complaint and application for deferred accounting:

> We now turn to URP's Application for deferred accounting filed in 1989. The deferral URP requests is very different from the deferral we ordered above of excess revenues which Pacific will receive subsequent to this order. That deferral is clearly within the scope of ORS 757.259, as we noted. URP's Application asks for deferral of excess revenues back to the time of application in 1989. We conclude that URP's Application must be denied because the deferral is not permitted by that statute and is not otherwise sanctioned by law.

Id. at 8. The Commission rejected URP's Application for three reasons, discussed below. Each was conclusive in UE 76; and each requires rejection of URP's Application in this docket.

A. URP'S APPLICATION IMPROPERLY SEEKS TO USE DEFERRED ACCOUNTING WITH A GENERAL RATE COMPLAINT

Deferred accounting is a mechanism to address variations in costs or revenues between rate cases. It allows the utility to defer the recovery from, or credit to, customers of unexpected

variations in costs or revenues, respectively, until a later time. This may assist in reducing the frequency of rate fluctuations or serve to match costs borne by customers and benefits received by customers. The main point here is that this rate-making tool is designed for use between rate proceedings.

The Legislature never intended that the Commission use deferred accounting in conjunction with a general rate complaint or rate-making proceeding, as URP tried in UE 76, and URP suggests again here:

> For permanent, long term increases in utility rates, the procedures of ORS 757.210, including interim rate increases, are appropriate. For the most part, deferrals under ORS 757.259(2)(c) were to be for discrete items which might substantially affect a utility's earnings on a short term basis. Accounts must be authorized every 12 months and amortized to rates after an earnings review. And, except in limited circumstances not applicable here, *it was never contemplated that this statute would serve any function, once a rate proceeding was under way*.

Id. at 8-9 (emphasis added).

The Commission did not base this conclusion on the particular facts in UE 76. Fundamental principles of Oregon ratemaking—in particular, the rule against retroactive ratemaking—support this conclusion. The rule against retroactive ratemaking prevents the Commission from setting rates based upon the prior earnings of the utility. UM 989, Order No. 02-227 at 9. The Oregon utility statutes codify the doctrine in ORS 757.225, which provides that the tariff rates are "the lawful rates until they are changed as provided in ORS 757.210 to 757.220." UCB 13, Order No. 03-401 at 8.

Oregon's regulatory scheme enables any party to file a rate complaint under ORS 756.500 or the Commission to bring its "own motion" proceeding to examine a utility's rates (ORS 756.515). The Oregon statutes also provide that the utility may demand a contested case proceeding before entry of a final rate order changing rates. ORS 756.515(5) and (6). If

parties justify a rate change in that contested case proceeding, the Commission may set new rates on a prospective basis.

The utility statutes and the rule against retroactive ratemaking do not permit the Commission to declare existing rates interim subject to refund based on the outcome of a general rate case proceeding. The Commission reached this conclusion in docket UT 85 and the Court of Appeals agreed:

> The effect of an order declaring those existing rates to be interim would have been to allow a rate reduction before the reduced rate had been approved; it would, in essence, have been retroactive adjustment . . . We hold that it was not error for the PUC to refuse to declare PNB's existing rates to be interim and subject to refund.

Pacific Northwest Bell v. Eachus, 135 Or App 41, 49-50, 898 P2d 774 (1995).

In UE 76, the Commission rejected URP's deferral application for just this same reason:

> In substance URP is requesting that the Commission order deferral of excessive earnings of the utility measured by the revenue requirement found in this proceeding to be appropriate on an ongoing basis for permanent rates. The Commission does not believe that such a request should be a matter for deferred accounting or would be authorized by the deferred accounting statute. While the Commission once had power to capture excessive earnings of a utility, a form of retroactive rate-making, that power was repealed by the legislature in 1971.

Order No. 92-1128 at 9 (internal citations omitted).

URP's current deferred accounting application suffers from the same defect. URP's allegations center on PGE's current rates, alleging that they are unjust and unreasonable. But that is the basis of a general rate complaint or general rate-making proceeding with prospective-only outcomes, not deferred accounting. The deferral statute does not authorize deferred accounting for general claims of "unjust and unreasonable" rates. And permitting a deferral to accompany a general rate complaint violates fundamental principles of Oregon ratemaking by seeking to exact a retroactive adjustment based upon the outcome of a general rate case proceeding.

B. URP'S APPLICATION DOES NOT FIT ANY OF THE STATUTORY PROVISIONS IDENTIFIED

Even if URP's Application did not accompany a general rate complaint, it would fail to fit any of the statutory bases for deferred accounting. URP's Application identifies two provisions – subsections 1(a) and 2(e) of ORS 757.259— neither of which authorizes URP's Application. Application, ¶ 5(b). The first, Subsection 1(a), has nothing to do with the Commission's authorization of deferred accounts. It authorizes the Commission to *amortize* deferred amounts, but it provides no legal basis to defer costs or revenues.[3]

Neither is Subsection 2(e) applicable. That subsection allows for the deferral of "[i]dentifiable utility expenses or revenues, the recovery or refund of which the commission finds should be deferred in order to minimize the frequency of rate changes or the fluctuation of rate levels or to match appropriately the cost borne by and benefits received by ratepayers." The Commission has interpreted this provision as imposing a two-prong test. UM 1147, Order No. 05-1070 at 5.

URP's Complaint does not satisfy the first prong of that test—minimize the frequency of rate changes. In theory, the Commission could change rates after completion of a contested case concerning URP's complaint and entry of the final rate order. But, as addressed above, Oregon law does not permit a complainant under ORS 756.500 to request interim rates; nor may the Commission grant interim rate relief based upon a complaint. *See* ORS 756.515(5) and (6); *Pacific Northwest Bell*, 135 Or App at 49-50. Given the unavailability of interim rates in these circumstances, granting deferred accounting will not minimize the frequency of rate changes.

[3] ORS 757.259(1)(a) provides as follows: "In addition to powers otherwise vested in the Public Utility Commission, and subject to the limitations contained in this section, under amortization schedules set by the Commission, a rate or rate schedule: (a) may reflect: (A) Amounts lawfully imposed retroactively by order of another government agency or (B) Amounts deferred under subsections(2) of this section."

Nor will the deferral serve to match "cost borne by and benefits received by customers"—the second prong under ORS 757.259(2)(e) As a threshold matter, this prong has no application. It applies where the utility incurs expenses or receives revenues (such as from a wholesale sale) and the Commission determines that recognition of the cost or revenue item should be deferred so that the rate adjustment matches the costs or revenues to the appropriate set of customers. UM 480, Order No. 92-1130 at 2 ("Deferrals should be authorized pursuant to ORS 757.259(2)(c) [now ORS 757.259(2)(3)] to match appropriately the cost borne by and benefits received by ratepayers. Deferred accounting is reasonable because customers are enjoying the benefits of extraordinary purchases and other actions of Idaho Power which assured continued service").

The "deferral" of *retail* revenues does not fall under this "matching " principle. The Commission rejected URP's deferred accounting application in UE 76 for this reason:

> [H]ere there has been no demonstrated change of a discrete cost of the utility. The appropriate "matching of costs and benefits" which is described as a purpose of this statute does not apply in this case. The costs and benefits which are to be matched are related to each other. Here the statute means that in the instance where a cost being experienced by a utility today related to a benefit which may be received by a customer in the future, the Commission may defer recovery of such cost until such time as the related benefit can be delivered to the customer.

Order No. 92-1128 at 9.

We say only that "*retail* revenues" cannot satisfy the "matching" principle because the "matching" principle applies symmetrically for costs that the utility bears and wholesale revenues and other revenues (such as rental payments for the use of utility poles) that the Commission credits to customers when determining a utility's revenue requirement. Moreover, the Commission may defer retail revenues under the first prong of (2)(e) if it finds that the deferral will decrease the frequency of rate changes. For example, in UE 76, the Commission

appropriately deferred retail revenues PacifiCorp would receive after entry of the final order because doing so avoided a rate change. As discussed above, this is unavailing to URP in this docket because interim rate relief is not available.

Just as in UE 76, URP's Application does not seek to defer a cost or recognize an appropriate wholesale or other revenue item. URP's Application seeks to use a deferral to refund money to customers. But that misses the statutory mark. The "matching" principle in Subsection 2(e) is concerned with deferrals that delay the recognition of a cost or delay recognition of wholesale or other revenues to better match the customers that pay the cost with those that receive the benefit. URP's Application does not fit this mold.

The Commission has used another reason for rejecting the notion that granting the Application will match "the cost borne by and benefits received by customers." The Commission has already determined that its stand-alone approach—which is the basis for PGE's current rates—appropriately balanced costs and benefits for customers.[4] UM 1073, Order No. 03-214 (declining to investigate the rate-making treatment of the expenses); UCB 13, Order No. 03-401 (dismissing complaint based upon past collections associated with tax expenses). In fact, the Commission concluded that it should "ignore" URP's request for deferred accounting concerning tax expenses in an earlier docket for just this reason. Order No. 03-401 at 6.

In UCB 13, URP complained about tax expenses collected from customers, just as it has here. In that docket, URP focused on the tax expense included in rates in the past. URP stated that it intended to file for deferred accounting. UCB 13, Order No. 03-401 at 6; Order No. 03-629 at 1. The Commission dismissed the complaint (because it violated the rule against retroactive ratemaking) and denied the request for deferred accounting, in part because URP

[4] As discussed below, SB 408 does not alter this conclusion because that bill applies after the date of its enactment (September 2, 2005) and no sooner.

failed to recognize that the Commission's stand-alone approach properly allocated risk and reward:

> The benefits to customers are obvious. Our policy prevents a holding company from transferring unjustifiable expenses to the utility or taking actions that would improperly inflate the utility's cost of capital. It also prevents the parent from imposing costs on ratepayers by using utility assets for purposes unrelated to customers' needs. . . . If PGE's rates were set in a manner that captured some of Enron's tax losses, PGE's rates would also have needed to reflect the expenses that created those tax savings, and customers would be worse off. Staff's counsel advised that it would be difficult for the OPUC to justify picking and choosing which of Enron's revenues and expenses—including tax savings—to include for the purpose of setting customers' rates.

UCB 13, Order No. 03-401 at 6-7.

In short, the stand-alone approach matched tax benefits with those that bore the cost or risk that gave rise to those tax benefits. It satisfied what the Department of Justice described as the benefits/burden test. Memorandum from Jason Jones to Commissioners Beyer, Baum and Savage, dated February 18, 2005, at 6-8. The stand-alone treatment of tax expense is the Commission's long-standing rate-making approach. *In re Oregon Exchange Carrier Ass'n*, Order No. 93-328, 1993 WL 117620 at *5 (March 12, 1993).[5] The Legislature did not intend for the Commission to apply SB 408 retroactively or for the bill to change the Commission's rate-making principles or tools other than through the establishment of an automatic adjustment clause. SB 408 § 3(4).

C. URP'S APPLICATION DOES NOT SEEK TO DEFER AN "IDENTIFIABLE" UTILITY EXPENSE OR REVENUE

In UE 76, the Commission rejected URP's deferral application for another reason that is applicable in this docket. Only "identifiable" utility costs and revenues are eligible for deferred

[5] "As a general proposition, income tax attributable to regulated operations is allowed as an expense for rate-making and hence for [the utility]. The Commission's policy has been to calculate the tax liability on a stand-alone basis. This is accomplished by calculating a tax liability based solely upon the earnings of the utility on its regulated operations. This tax liability is recognized for ratemaking purposes, whether or not the Company overall has an actual tax liability."

accounting. In UE 76, the Commission rejected the deferral application because it sought to defer revenues based upon the overall outcome of utility operations. The request did not seek to defer a particular item that the Commission can easily quantify, like advertising costs or power costs. It sought to defer "excess earnings", *i.e.*, earnings above what the Commission may determine to be the appropriate revenue requirement. This is not an "identifiable cost or revenue." Rather, it is the overall outcome of all the utility's costs and all the utility's revenues, along with a determination of the allowed return on equity. Order No. 92-1128 at 9.

Tax expense similarly reflects the overall outcome of utility operations, not a particular expense or revenue item. Any income tax that one could deem "collected" in rates would relate to the amount of revenue in that year available for gross income which, in turn, would depend on specific revenues and costs received or incurred in that year. Because income tax is an outcome of the entire equation, it is not comparable to one revenue or expense item, such as revenue from gas pipeline capacity release.

Determining the amount of revenue the utility collects from customers for tax expenses becomes even murkier when we consider the indirect connections between actual costs, revenues and tariff rates. The Commission establishes tariff rates based on a series of assumptions regarding test year costs, loads, revenues, tax expense, and other rate-making components. Once the Commission sets those tariff rates, actual costs and revenues almost always vary from test-year projections. But this makes it nearly impossible to allocate what customers pay for particular cost items. For example, suppose that PGE's O&M actual expenses are $15 million higher than forecasted but A&G expenses are $15 million lower than forecasted. Customers paid the "correct" amount for total costs, but how should we allocate revenues? Have customers not paid for the extra $15 million in O&M just because this was not part of forecasted costs? Are

revenues for A&G attributed to actual cost that did not occur? Or should those revenues to be allocated to the higher than expected O&M expenses? To ask these questions is to realize that there is no right answer.

Because the Commission derives the tax expense from other rate components and because of the indefinite relationship between tariff rates and actual cost and revenues, the amount customers pay in rates for tax expense is indeterminate. One can only assign a number based upon a set of assumptions and allocation techniques. For PGE's 1997-2004 Annual Report of Operations, it used actual gross revenues, actual operating expenses, actual tax credits, and actual federal and state tax rates to calculate the amount.

The specifics of the calculation are not the point here. All that matters is that the figure does not reflect an "identifiable utility expense or revenue" item that the Commission may defer under the general deferral statute. It reflects the overall outcome of the utility's operations based on actual expenses, actual revenues, and assumptions regarding the complex relationship between tariff rates, particular costs and what the utility collects from customers.

URP's Application falls outside the plain terms of ORS 757.259(2)(e) for the reasons set forth above. The nature of deferred accounting further confirms that conclusion. The Commission interprets the deferred accounting statute narrowly because it is an exception to the rule against retroactive ratemaking. The Commission will not grant applications for deferred accounting unless it is "clearly within the reach of the statute." Order No. 92-1128 at 8. URP's Application does not meet this heightened standard.

IV. THE COMMISSION SHOULD EXERCISE ITS DISCRETION TO DENY URP'S APPLICATION

In some cases the Commission has first considered whether it should exercise its discretion to grant a deferred accounting request before determining the legal sufficiency of the

Application. UM 1071, Order No. 04-108 at 8. If the Commission adopts this approach, it should exercise its discretion to reject the Application. URP's Application creates significant risk for customers, provides no benefit that SB 408 will not provide, and will impose unduly burdensome regulatory demands on the Commission.

A. URP'S APPLICATION COULD VIOLATE IRS NORMALIZATION RULES

Granting URP's Application could jeopardize the availability of accelerated depreciation deductions under the federal tax code. Utilities that do not observe normalization rules risk losing the ability to take advantage of accelerated depreciation deductions available under the federal tax code. *See* Treatment of Income Taxes in Utility Ratemaking, a White Paper Prepared for the Oregon Legislative Assembly by the OPUC Staff, February 2005 ("Staff White Paper") at 6. URP's Application, if granted, would enable the immediate flow through to customers of the benefits of accelerated depreciation, which would directly violate IRS normalization rules. *Id.* Staff has estimated that the loss of accelerated depreciation deductions would cost PGE's customers between $20 million and $30 million per year. Staff White Paper at 9. In this regard, URP's Application lacks the safeguards SB 408 establishes. SB 408 has a specific provision that permits deferred taxes to be included in rates and any other "tax requirements and benefits that are required to be included in order to ensure compliance with the normalization requirements of federal tax law." SB 408, § 3(8)(b).

B. COMMISSION DOCKET AR 499 ADDRESSES THE ISSUE URP SEEKS TO RAISE

In exercising its discretion under ORS 757.259(2)(e), the Commission considers "whether there are other, more appropriate regulatory tools to address recovery of the identified costs or revenues." UM 1147, Order No. 05-1070 at 10. The Commission has already opened docket AR 499 to issue permanent rules implementing SB 408. Those rules will effectuate the

automatic adjustment clause authorized in section 3(4) of the bill. The SB 408 automatic adjustment clause will provide the same mechanism URP's Application seeks to implement—namely a true up of tax expenses paid in rates with actual taxes paid to taxing authorities.

The AR 499 docket, and a docket related to a specific automatic adjustment clause for PGE under SB 408, is the superior forum in which to address these issues. The AR 499 docket has already been opened and opening comments submitted. All the affected utilities and customer groups have intervened and are participants in AR 499, ensuring that the Commission will have the benefit of hearing from all affected parties, not just one intervenor and one utility. The participation of all utilities also ensures a consistent outcome for all affected utilities and customers. Commission Staff has stated that it will ask the Commission to open related AAC dockets by November 22, 2005. SB 408 directly authorized the automatic adjustment clause and the implementing rules that the Commission will promulgate in AR 499. In contrast, URP's Application lacks any statutory authority. All factors point to AR 499 as the appropriate forum to resolve these issues; URP's Application is not.

C. URP'S APPLICATION WILL IMPOSE UNDUE REGULATORY AND ADMINISTRATIVE BURDENS

Even if "revenues associated with tax expenses" is a deferrable item as a legal matter, the administrative and regulatory burdens associated with determining what amounts are collected for tax expenses are too great to warrant approval of URP's Application. As the participants in AR 499 can confirm, these issues are complex and challenging with the benefit of a specific bill addressing the topic. These complexities will be insuperable without the aid of specific statutory guidelines. Moreover, permitting URP's Application to proceed in a docket parallel with the AR 499 proceeding will create a substantial risk of inconsistent outcomes. These regulatory risks and burdens are real and suggest the Commission should decline the Application.

V. SB 408 DOES NOT AUTHORIZE URP'S APPLICATION

The unstated yet clear assumption underlying URP's Application is that SB 408 authorizes URP's deferral. URP is wrong. SB 408 is irrelevant to URP's Application.

First, URP's Application is under the general deferral statute and SB 408 did not amend or alter in any fashion ORS 757.259. Indeed, URP identifies ORS 757.259 as the sole legal authority for its Application. Application, ¶ 5(b).

Second, URP seeks to defer revenues received in 2005. SB 408 neither contains nor authorizes any mechanism for use in 2005. SB 408 requires the Commission to align taxes paid in rates with taxes paid to units of government. The Commission accomplishes this alignment through the use of the automatic adjustment clause. SB 408, § 3(4). But under Section 4, the automatic adjustment clause may be applied only to taxes paid and collected from ratepayers on or after January 1, 2006. As such, SB 408 authorizes no deferral of revenues before January 1, 2006, which is exactly what URP's Application seeks. The Commission may authorize deferrals after January 1, 2006, to support the operation of the automatic adjustment clause, but this is not what URP seeks.

VI. CONCLUSION

For the reasons stated above, the Commission should deny URP's Application.

DATED this 10th day of November, 2005.

/s/ DOUGLAS C. TINGEY
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CERTIFICATE OF SERVICE

I hereby certify that on this day I served the foregoing **PORTLAND GENERAL ELECTRIC COMPANY'S COMMENTS ON UTILITY REFORM PROJECT'S APPLICATION FOR DEFERRED ACCOUNTING** by mailing a copy thereof in a sealed envelope, first-class postage prepaid, addressed to each party listed below, deposited in the U.S. Mail at Portland, Oregon.

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DATED this 10th day of November, 2005.

/s/ DOUGLAS C. TINGEY
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