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VIA ELECTRONIC FILING

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Public Utility Commission of Oregon
PO Box 2148
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Re: Docket AR 537

Enclosed for filing in the above-referenced docket are Comments of the Joint Utilities, PacifiCorp, Portland General Electric, Avista, and NW Natural.

Very truly yours,

Katherine A. McDowell

Enclosures

cc (w/encl.): David White
Doug Tingey
David Meyer
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Joint Comments of PacifiCorp, Portland General Electric, Avista, and NW Natural
AR 537—Proposed Amendment to OAR 860-022-0041(10)

I. INTRODUCTION

PacifiCorp, Portland General Electric, Avista, and NW Natural (the "Joint Utilities") submit these comments in response to the Notice of Rulemaking filed on July 15, 2009, which the Public Utility Commission of Oregon ("Commission") docketed as AR 537. The AR 537 rulemaking proposes a permanent rule change to OAR 860-022-0041, the rule implementing Senate Bill 408 ("SB 408").[1] The rule change is identical to that implemented in a temporary rule amendment to OAR 860-022-0041(10), adopted on April 14, 2009 and expiring on October 9, 2009.

While the AR 537 caption states that it is amending OAR 860-022-0041 to be consistent with ORS 757.268 (SB 408), the Joint Utilities do not believe that any change to the existing rule is required for consistency with ORS 757.268. Moreover, the proposed rule change violates ORS 756.040 by improperly limiting the scope of a utility's confiscatory rate challenge.

The Commission should allow the temporary rule to lapse without adoption of the proposed rule. Alternatively, the Commission could use the AR 537 rulemaking to clarify the language of OAR 860-022-0041(10) in two ways: (1) affirm that the earnings review should be conducted on the utility's earnings during the applicable tax year, but make clear that the earnings should be adjusted to reflect the full SB 408 rate adjustment if necessary; and (2) clarify that the new language "after filing a tariff implementing an automatic adjustment clause" refers to the tariff filing initially establishing an SB 408 automatic adjustment clause ("AAC"), not the compliance filing made annually for surcharges or refunds under the AAC. To accomplish this, the Joint Utilities propose the following change to the language of the proposed rule:

> At any time after filing a tariff ~~implementing~~ initially establishing an automatic adjustment clause a utility may file a claim that a rate adjustment under the automatic adjustment clause violates ORS 756.040 or other applicable law. In making a determination regarding a potential violation of ORS 756.040, the Commission will ~~examine the utility's projected earnings during the period the automatic adjustment clause would be in effect~~ perform an earnings review using the utility's results of operations report for the applicable tax year, adjusted as necessary to reflect the SB 408 rate adjustment for the applicable tax year and remove SB 408 rate adjustments from any prior period.

II. BACKGROUND

In Order No. 09-135, the Commission adopted a temporary amendment of OAR 860-022-0041 (10), which made the following additions and deletions to the original rule:

[1] SB 408 is codified in ORS 757.267, 757.268 and 757.210.

> At any time~~,~~ after filing a tariff implementing an automatic adjustment clause a utility may file a claim that a rate adjustment under the automatic adjustment clause violates ORS 756.040 or other applicable law. In making a determination regarding a potential violation of ORS 756.040, the Commission will ~~perform an earnings review using the utility's results of operations report for the applicable tax year~~ examine the utility's projected earnings during the period the automatic adjustment clause would be in effect.

The Commission's stated purpose in adopting the temporary rule was twofold. First, the Commission remedied what it perceived as a discrepancy between SB 408 and OAR 860-022-0041(10) regarding the time period applicable to the Commission's examination of the utility's earnings to determine whether a rate adjustment under an AAC would violate ORS 756.040 or would have a material adverse effect on customers. Order No. 09-135 at 1. The Commission reasoned that SB 408 requires the Commission to examine the utility's rates during the period the AAC is in effect, not during the applicable tax year. Presumably, the Commission meant to refer to the period in which the rate refund is in effect, since all of the utilities' AACs have been in effect since January 2008, as a result of Order No. 08-045.

Second, the Commission clarified that a utility must make a claim that a rate adjustment pursuant to an SB 408 AAC violates ORS 756.040 or would cause a material adverse impact on customers after tariffs establishing the AAC have been filed. Order No. 09-135 at 2. Again, presumably, the Commission meant to refer to the period after compliance tariffs are filed implementing a rate refund, since all of the utilities filed tariffs establishing their AACs in January 2008, which were approved in Order No. 08-045.

The temporary rule emerged from *In re Avista*, Docket UG 171(1), Order No. 09-125 (April 10, 2009) ("*Avista* Order"), in which the Commission rejected a stipulation addressing Avista's 2007 tax report. The proposed rule change is unnecessary to address the primary concern the Commission articulated in the *Avista* Order, however, which is the need for an express finding that an SB 408 rate refund would be confiscatory before the Commission may disallow the refund.

The rule amendment is neither required by ORS 757.268 nor consistent with ORS 756.040. The proposed rule purports to require a review of the earnings impact of a SB 408 rate adjustment on a utility during a time period different than the one from which the rate adjustment was derived. This mismatch violates ORS 756.040 and creates numerous evidentiary and practical problems. Furthermore, the language of the proposed rule incorrectly conflates the establishment of an AAC with the implementation of a rate refund under the AAC, creating ambiguity as to the rule's meaning and application.

III. DISCUSSION

A. The *Avista* Order and Its Implications for a Confiscatory Rate Challenge.

In the *Avista* Order, the Commission rejected a stipulation among the parties to UG 171, Avista's 2007 tax report docket. As filed, Avista's tax report resulted in a refund of $1.98 million, plus $400,000 in interest. Because of concerns that the refund would result in confiscatory rates in violation of ORS 756.040, the stipulation proposed to suspend the refund, but require Avista to forego up to $500,000 per year of any SB 408 surcharges from 2008 to 2012.

Importantly, while the stipulation acknowledged concerns that a refund might result in confiscatory rates, it did not include an agreement that the refund would actually result in confiscatory rates.

In its Order, the Commission stated that "the only question for our resolution is whether this Commission has the discretion under ORS 757.268 to allow Avista to forego the refund in the absence of a finding that a refund would result in confiscatory rates or otherwise have a 'material adverse effect on customers.'" Order at 2-3. The Commission concluded that it lacked the discretion to approve a Stipulation that permitted Avista to forego providing a SB 408 refund "based solely on the concern that the refund 'could' result in confiscatory rates." Order at 4.

The Commission then clarified that it did have authority to address Avista's confiscatory rate claim. It found that such a claim should be pursued in the same manner as a "material adverse effect" claim under ORS 757.268(9) and (10). The Commission stated that such a challenge could be pursued "[a]fter an automatic adjustment clause implementing the rate adjustment is approved, and the utility filed tariffs establishing the clause." *Id.*

The holding of the *Avista* case is that the Commission may not suspend a refund under an AAC without a finding that the refund would result in confiscatory rates. The procedural direction it provides is only that a confiscatory rate challenge be brought after the AAC is established.

Four days after the *Avista* Order, the Commission adopted the temporary rule amendment to OAR 860-022-0041(10) purporting to change the earnings review period for a confiscatory rate claim from the applicable tax year to the period in which the rate adjustment will be in effect. This issue was not addressed in any manner in the *Avista* case. The temporary rule also addressed the timing of a confiscatory rate challenge and adopted a position consistent with the Commission's statements in the *Avista* case.

B. ORS 757.268 Does Not Require Use of the Rate Adjustment Period for the ORS 756.040 Earnings Review.

The order implementing the temporary rule states that "[u]nder SB 408, the Commission should determine whether a rate adjustment under an automatic adjustment clause would violate ORS 756.040, or would otherwise have a 'material adverse effect on customers,' by examining the utility's rates during the period the automatic adjustment clause is in effect, not during the applicable tax year." Order No. 09-135 at 1-2. While the Commission's order concluded that the current rule requiring use of the applicable tax year for an earnings review for a confiscatory rate challenge "conflicts with ORS 757.268," the order does not explain this conclusion.

The Statement of Need in the AR 537 rulemaking notice provides that: "According to ORS 757.268, the Commission reviews a utility's tax report to determine whether a rate adjustment under an automatic adjustment clause violates ORS 756.040 or otherwise has a 'material adverse effect on customers' by examining the utility's rates during the period the automatic adjustment clause is in effect, not during the 'applicable tax year." This statement is not supported by citation to specific language in ORS 757.268.

There is no statutory basis for the conclusion that ORS 757.268 requires the use of the rate adjustment period for an earnings review under ORS 756.040. The statute does not expressly address the issue and to imply such a requirement would necessitate adding

additional text to the statute. When interpreting statutes, Oregon law requires a court to declare what is contained in the statute, not to insert what the legislature has omitted. ORS 174.010.

ORS 757.268(9) and (10) do expressly address challenges alleging that an automatic adjustment clause would have a material adverse effect on customers. ORS 757.268(9) and (10) allow a party to challenge "establishing" an automatic adjustment clause and, after a hearing under ORS 757.210, the Commission may issue an order "terminating" the clause. This language does not support the proposed rule for several reasons. First, it pertains to challenges alleging a material adverse effect, not confiscatory rate challenges under ORS 756.040. While there are similarities between these two types of challenges, there are also important distinctions, including the fact that a challenge under ORS 756.040 implicates constitutional considerations. Second, ORS 757.268(9) and (10) only indirectly address timing and procedure for challenging the AAC and do not provide substantive standards to be applied to such challenges. To the extent that any process requirement could be reasonably implied in these sections, it is only that a challenge must be brought to "establishing" an automatic adjustment clause. Because the Commission already "established" automatic adjustment clauses for all utilities in January 2008 in Order No. 08-045, the proposed rule is not required to satisfy these sections of ORS 757.268.

Furthermore, nothing in the context of SB 408 indicates that the rate adjustment period must be used for an ORS 756.040 earnings review. Although SB 408 implements a prospective AAC, it uses a retrospective analysis of taxes paid to determine whether the Commission must implement an AAC. Because SB 408 is not attempting to predict what taxes will be on a forward-looking basis, but instead functions as a retrospective, true-up mechanism, it is consistent with the context of SB 408 to use a retrospective period for the earnings review.

In analogous contexts, the Commission has used the utility's financial results from an historic period for an earnings review. For example, when the Commission conducts earnings reviews to determine whether to allow amortization of a deferral under the deferral statute, ORS 757.259, the Commission uses the utility's financial results from a 12-month period that includes all or part of the period during which the deferral occurred. OAR 860-027-0300(9). The period must be reasonably representative of the deferral period. *Id.*

In addition, the earnings review adopted by the Commission for use in Purchased Gas Adjustment mechanisms is retrospective—based upon the same year the utility incurred the gas costs at issue. OAR 860-022-0070(4). The Commission also uses a retrospective test period for Idaho Power's PCAM earnings review. *Re Idaho Power Co.*, Docket UE 195, Order No. 08-238 (Apr. 28, 2008).

C. Sound Ratemaking Principles and ORS 756.040 Require a Match between the Earnings Review Period and the Year from which the Rate Adjustment was Derived.

In the Attorney General's opinion addressing the Commission's implementation of SB 408, the Attorney General made clear that the requirement that rates be fair and reasonable under ORS 756.040 limits the Commission's discretion in implementing SB 408. The Attorney General stated that "[r]egardless of the approach finally adopted by the Commission, the rates ultimately allowed must be 'fair and reasonable' under ORS 756.040(1)." Attorney General Opinion at 16. ORS 756.040 provides that rates are fair and reasonable if they provide adequate revenue for both the utility's operating expenses and capital costs, and a return on investment that is "commensurate with the return on investments in other enterprises having

corresponding risks; and . . . [s]ufficient to ensure confidence in the financial integrity of the utility, allowing the utility to maintain its credit and attract capital." ORS 756.040(1).

As a result of GAAP principles, utilities experience the impact of an SB 408 rate refund or surcharge when the difference between taxes collected and taxes paid is accounted for on a utility's books. This accounting can occur over multiple years, beginning with the applicable tax year. In most, if not all cases, the accounting will take place prior to the rate adjustment period. If the Commission uses the rate adjustment period to conduct an ORS 756.040 earnings review, the Commission will be evaluating the utility's earnings in a time period that is removed in time from the one in which the utility actually absorbed the impact of the rate adjustment. Sound ratemaking principles require a matching of the earnings review period and the actual financial impact of the SB 408 rate refund or surcharge.

The Commission recently recognized that general ratemaking principles suggest matching the earnings review period with the historical period in which the true-up mechanism is applied. *Re. Utility Reform Project and Ken Lewis Application for Deferred Accounting*, Docket UM 1224, Order No. 09-316 (Aug. 18, 2009). In UM 1224, the Commission addressed the same issue as the one in this rulemaking, only under a different statute. There, the Commission determined the time period to which an earnings test is applied under the general deferred accounting statute. One party in that docket had argued that an earnings test under ORS 757.259 should be applied, not to the deferral period, but instead to a period that would include the amortization period. After concluding that the statute and legislative history left some room for doubt, the Commission turned to "general principles of ratemaking [to] guide us." *Id.* at 14. Ratemaking principles required the Commission to consider the utility's operation and financial performance during the deferral period, not some future amortization period that may be completely divorced from the period from which the deferred amount is derived:

> Based on this reasoning, we conclude that ORS 757.259(2) directs us to review a utility's earnings for an interval that includes the deferral period. Reviewing earnings that are entirely distinct from the deferral period would be inconsistent with general principles of ratemaking and deferred accounting.

Id. Given that ORS 757.268 does not require the Commission to use the amortization period for its earnings review, the Commission should find that, consistent with general ratemaking principles, the earnings review period is the applicable tax year.

Not only would matching the time period used to calculate an SB 408 rate adjustment and the period used in the earnings review comport with sound ratemaking, but failing to do so would violate ORS 756.040. For example, using a mismatched time period to evaluate earnings could result in a false finding that rates are not confiscatory simply because the low-earnings year that produced the rate adjustment is ignored and replaced with a subsequent, higher earnings year. In essence, the Commission would be avoiding a finding of confiscatory rates by evaluating rates during a period that is not relevant to the time period in which the rate adjustment causing the confiscatory rates was calculated. Such a result would conflict with ORS 756.040. The only way to ensure that an SB 408 rate refund does not violate ORS 756.040 is to review the utility's earnings in the time period the Commission used to determine whether a refund would occur, *i.e.*, the applicable tax year.

The Commission's proposed mismatch between the applicable test year and the earnings review period is especially problematic from the standpoint of ORS 756.040 because

of SB 408's "double whammy." The Commission has acknowledged that SB 408 presents the problem of the "double whammy," wherein lower-than-expected earnings in a given year reduce taxes paid, making it more likely that a utility must refund taxes collected in that year. *Re. Adoption of Permanent Rules to Implement SB 408 Relating to Utility Taxes*, Docket AR 499, Order No. 06-532 at 10 (Sept. 14, 2006). The "double whammy" exacerbates a utility's underrecovery when earnings are lower than anticipated. By using an earnings review period that is unrelated to the calculation of the SB 408 rate adjustment, the Commission magnifies the "double whammy" problem. Under the proposed rule, the Commission will ignore evidence of the depressed earnings that produced the double whammy and effectively deprive the utility of the safety net of ORS 756.040 when it most needs it. In essence, the proposed rule creates a "triple whammy," by measuring the confiscatory nature of a rate refund caused by the double whammy in a year other than the low-earnings year that produced it.

The mismatch between the applicable tax year and the earnings review period in the proposed rule creates multiple practical and evidentiary problems as well. Staff has already encountered such problems in its evaluation of Avista's earnings review in UE 171(1) and noted that the problems resulted in a "highly speculative" earnings review. *Re. Oregon Public Utility Staff Requesting the Commission Direct Avista Utilities to File Tariffs Establishing Automatic Adjustment Clauses Under the Terms of SB 408*, Docket UG 171, Staff/200, Garcia 4-5 (July 28, 2009).

First, because the utilities reflect the financial impact of the SB 408 refund or surcharge on their books prior to the rate effective period, the earnings in the rate adjustment period will not properly reflect the impact of the refund or surcharge unless adjustments are made for this issue. To remedy this problem in UG 171(1), when Avista conducted the earnings review on the rate effective period,[2] Avista removed its 2008 SB 408 accrual and added its 2007 SB 408 refund.

Second, the proposed rule requires preparation of a comprehensive earnings forecast. Because the temporary rule purports to require an earnings review on a prospective basis, in UG 171, Avista had to rely upon projected earnings based on 2008 results, with various restating adjustments. As Avista noted in its testimony in that case, the temporary rule essentially requires the parties to create a hypothetical rate case for the projected period. *Re. Oregon Public Utility Staff Requesting the Commission Direct Avista Utilities to File Tariffs Establishing Automatic Adjustment Clauses Under the Terms of SB 408, Docket UG 171*, Avista/300, Norwood/15 (June 15, 2009). Creating a rate case for this purpose is a drain on the Commission's and the parties' resources and may make it impossible for a utility to produce an earnings review in a timely manner. *Id.* Avista explained that the only reason it could timely produce results under the temporary rule was because it was already close to completing its rate case. *Id.* Requiring such a burdensome earnings review improperly constrains a utility's ability to bring a confiscatory rate challenge.

Third, to the extent that a utility is required to include projected rate increases into its earnings review, this completely undermines ORS 756.040. Avista's earnings review includes a forecast rate increase granted March 1, 2010—required because Avista's earnings are well below its authorized return on equity. The goal of the earnings review is to determine whether the SB 408 refund reduces the utility's earnings to a degree that is confiscatory and in violation

[2] Avista conducted two earnings reviews—one under the temporary rule and one under the prior rule.

of ORS 756.040. By permitting the inclusion of offsetting, speculative rate increases in the earnings review, the temporary rule negates the safeguards of ORS 756.040. Moreover, the Commission would be placed in the untenable position of deciding which proposed future rate increases are reasonable and which are not while a general rate proceeding is pending and before the general ratemaking record is closed.

In contrast, if the Commission conducts an earnings review based upon the applicable tax year, the Commission could rely upon filed results of operations reports. This is a much more accurate and reliable approach to reviewing a utility's earnings than one that attempts to project earnings performance in a forecast period.

D. Timing Issues

In the *Avista* Order, the Commission opined that a confiscatory rate challenge should follow the procedures contemplated by ORS 757.268(9) for a material adverse effect challenge. As noted above, under that section of SB 408, a material adverse effect challenge is directed at "establishing" an AAC and can result in "terminating" the clause. Based upon this rationale, the Commission concluded that a confiscatory rate challenge should be filed after the "the utility files tariffs establishing the clause." *Avista* Order at 4. The proposed rule tracks this language, allowing a confiscatory rate challenge only after the filing of a tariff implementing the automatic adjustment clause.

The fundamental problem with finding Avista's confiscatory rate challenge premature under this analysis, however, is that, as also noted above, the Commission "established" the utilities' AACs in January 2008 in Order No. 08-045. The Commission took such action after the utilities filed tariffs establishing the AACs. Thus, under the rationale of the *Avista* Order and under the proposed rule language, Avista's challenge should have been deemed timely because it was filed after the establishment of its AAC in January 2008. Put another way, as presently drafted, the language of the temporary rule and the proposed rule should permit a utility to bring a confiscatory rate challenge during the pendency of an annual AAC proceeding because the Commission has already established/implemented AACs for all of the utilities.

The Commission should allow a confiscatory rate challenge to a SB 408 refund at any time, as long as the Commission has established an AAC for the utility. The Commission should expressly adopt this interpretation of the proposed rule language.

IV. CONCLUSION

The Commission's concern in the *Avista* case does not appear to have been the timing of the confiscatory rate challenge or the period used for an earnings review, but rather the lack of an evidentiary record upon which the Commission could make a finding that the SB 408 rate refund would produce confiscatory rates. The Commission can address the evidentiary issues around confiscatory rate challenges without changing the SB 408 rule.

The proposed rule is not required by ORS 757.268, would violate ORS 756.040, and is inconsistent with general ratemaking principles. The Commission should either maintain the current rule or amend it for clarification purposes only. The Commission should use the applicable tax year for an earnings review in a confiscatory rate challenge under SB 408, adjusted as necessary to reflect the full impact of the SB 408 rate refund. This will avoid violations of ORS 756.040, result in more accurate earnings review results and alleviate the practical and evidentiary problems presented by the Commission's proposed rule. In any event,

the language of the proposed rule improperly eliminates the important distinction between the establishment of an AAC and the approval of a rate refund or surcharge under the AAC. The Commission should clarify that the language of the proposed rule allows a confiscatory rate challenge at any time, as long as the Commission has established an AAC for the utility.