

1 II. ARGUMENT

2 (A) **The Commission does not have the legal authority, pursuant to ORS 757.259(2)(e),**
3 **to defer the return *on* a utility’s capital investments for later inclusion in rates.**

4 ORS 757.259(2)(e), in relevant part, provides the Commission with the authority to
5 authorize the deferral of “identifiable utility *expenses* or *revenues*, the recovery or refund of
6 which the commission finds should be deferred in order to minimize the frequency of rate
7 changes or the fluctuation of rate levels or to match appropriately the costs borne by and the
8 benefits received by ratepayers.”² House Bill 2145,³ the genesis of ORS 757.259, was enacted in
9 1987 to provide the Commission with authority to grant deferrals, subject to the particular
10 provisions in the legislation. Absent an express grant of authority from the legislature, the
11 Commission cannot include in future rates past utility profits and losses, as doing so would
12 violate the rule against retroactive ratemaking.⁴ Although Oregon courts have not expressly
13 determined the contours of the rule against retroactive ratemaking in Oregon,⁵ they have stated
14 that a narrow interpretation of the rule is consistent with Oregon’s statutory scheme, which
15 contains specific exceptions to the rule.⁶ Accordingly, the Commission lacks the authority to
16 allow for later inclusion in rates amounts that are not considered “expenses” or “revenues”
17 pursuant to the specific exception in ORS 757.259(2)(e).

18 Courts apply the process set forth in *State v. Gaines* when determining the legislature’s
19 intended meaning for statutory terms.⁷ First, the court examines the statute’s text and context.⁸
20 The court may also consider any pertinent legislative history, if useful to its analysis.⁹ Finally, if

21 ² Emphasis added.

22 ³ H.B. 2145, 64th Oregon Leg. Assem., Reg. Sess. (Or. 1987).

23 ⁴ Or. Op. Atty. Gen. OP-6076 (Or.A.G.), 1987 WL 278316 at 1.

24 ⁵ *Gearhart v. Public Utility Com’n of Oregon*, 356 Or 216, 237 (2014).

25 ⁶ *Gearhart v. Public Utility Com’n of Oregon*, 255 OrApp 58, 99-100 (2013).

26 ⁷ *Blachana, LLC v. Bureau of Labor and Industries*, 354 Or 676, 687-688 (2014) (referring to *State v. Gaines*, 346 Or 160 (2009)).

⁸ *State v. Gaines*, 346 Or 160, 171 (2009).

⁹ *Id.* at 177.

1 the legislature’s intent remains unclear, the court will resort to general maxims of statutory
2 construction.¹⁰ “Whether any possible meaning comes within the intended meaning depends
3 upon the policy which the word or phrase is intended to convey.”¹¹

4 1. A utility’s rate of return is not a “revenue” or “expense” under ORS 757.259(2)(e).
5 “Revenues” and “expenses” are not defined by statute, and are considered inexact
6 statutory terms. Inexact terms are understood to embody a complete policy statement by the
7 legislature, despite the fact that they may be capable of contradictory applications, all of which
8 may be within the dictionary meaning of the term.¹² Generally, when the legislature has not
9 defined a particular word or phrase, courts assume that the word or phrase carries its ordinary
10 meaning.¹³ However, when the words are terms of art “drawn from a specialized trade or field,
11 courts look to the meaning and usage of those terms in the discipline from which the legislature
12 borrowed them.”¹⁴

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14 a. *“Revenues” and “expenses” are terms of art within the context of ORS
757.259(2)(e) and do not include return on utility investment.*

15 “Revenues” and “Expenses” are terms of art in utility ratemaking, and therefore, are
16 appropriately construed in the context of the ratemaking equation. As discussed more fully
17 below, this conclusion is supported by ORS 757.259’s legislative history.

18 Rates are set using the following ratemaking equation: $R = E + (V-D)r$, where “R” is the
19 revenue requirement; “E” is the utility’s operating expenses; “V” is the gross value of the
20 utility’s property; “D” is the accumulated depreciation of utility property; and “r” is the utility’s
21 authorized rate of return.¹⁵ In ratemaking, utility revenues typically include revenue items such

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23 ¹⁰ *Id.* at 171.

24 ¹¹ *Springfield Educ. Ass’n v. Springfield School Dist. No. 19*, 290 Or 217, 225 (1980).

25 ¹² *Id.*

26 ¹³ *Comcast Corp. v. Dept. of Rev.*, 356 Or 282, 296 (2014).

¹⁴ *Matter of Compensation of Muliro*, 359 Or 736, 746 (2016) (internal citations omitted).

¹⁵ *Gearhart*, 356 Or at 220.

1 as excess power sales and wheeling revenues.¹⁶ More generally, revenues are understood to be
2 benefits to customers in that they offset other utility operating expenses. Utility expenses
3 typically include several categories of expenses, including operations and maintenance expenses
4 and administrative and general expenses. A utility's depreciation expense is also reflected in the
5 expense part of the ratemaking equation, but unlike other types of utility expenses, depreciation
6 expense is unique in that it does not require a cash outlay from the utility.

7 Both utility expenses and revenues are found in the "E" portion of the ratemaking
8 equation, above. A utility's rate of return, on the other hand, is not part of its "expenses" or
9 "revenues" used for setting the utility's revenue requirement, as made clear in the equation
10 above. Rather, the utility's rate of return is reflected in the second part of the ratemaking
11 equation (" $(v-d)r$ "), and is not considered a revenue or expense for ratemaking purposes.

12 Because return on utility investment is neither a revenue, nor an expense, as
13 contemplated by ORS 757.259(2)(e), the Commission lacks the legal authority to approve a
14 deferral for revenue requirement effects that include a return on utility investment under the plain
15 meaning of the statute.

16
17 *b. Legislative history confirms the legislature intended that ORS 757.259 be
18 construed consistent with ratemaking definitions and principles.*

19 HB 2145 was filed, pre-session at the request of Public Utility Commissioner Charles
20 Davis, in direct response to informal legal advice from the Department of Justice (DOJ), which
21 raised considerable doubt as to whether the Commission possessed the authority to order
22 deferred accounting. On March 18, 1987, one week after the first public hearing for HB 2145
23 (House Environment and Energy Committee), DOJ provided Attorney General Opinion OP-6076
24 to Commissioner Davis, which formally concluded that the retroactive ratemaking orders,
25 including those that deferred the revenue requirement effects of capital investments, were

26 ¹⁶ The Commission has previously defined "operating expenses" as non-capitalized utility
expenses incurred in the operation of the utility, which are offset by revenues generated by utility
operations. *See e.g. In re Portland General Electric*, OPUC Docket No. UE 283, Order No. 14-
422 (Dec. 30, 2014) ("other revenue" included in the determination of revenue requirement.).

1 “absolutely impermissible unless they are expressly authorized by the legislature and do not
2 violate the Oregon and United States Constitutions.”¹⁷ A copy of this memorandum was
3 provided to legislators.¹⁸ Upon Representative Parkinson’s request,¹⁹ the legislature was also
4 provided with a glossary of terms applicable to HB 2145 to aid in the legislature’s understanding
5 of what was intended by the language in the bill.²⁰ In relevant part, defined terms included:

- 6 • “Accounting – Ratemaking” was defined as “[f]or a regulated company, accounting
7 practices and entries are largely controlled by the ratemaking treatment. Ratemaking
8 decisions can create assets and liabilities by postponement of recognition of
9 transactions which would enter into the determination of income for a non-regulated
10 firm entirely in one period or at an earlier time.”²¹
- 11 • “Deferral” was defined as “the postponement of recognition of income or expense
12 amounts. Deferrals may be subject to amortization, if rate recovery is permitted, or
13 may be fully reflected in one period’s income statement, if rate recovery is denied. A
14 deferred charge or debit account can increase required revenues, and a deferred credit
15 account can decrease required revenues.”²²
- 16 • “Gross revenues” was defined “[t]he sum of all revenues recorded for utility
17 operations, including sales to consumers, sales for resale, and other operating
18 revenues.”²³
- 19 • “Revenue requirements” was defined as “[t]he sum total of the revenues required to
20 pay all operating and capital costs of providing service.”²⁴

21 ¹⁷ Or. Op. Atty. Gen. OP-6076 (Or.A.G.), 1987 WL 278316 at 1.
22 ¹⁸ HB 2145 Senate Business, Housing and Finance Committee Exhibit P, Attachment 1.
23 ¹⁹ March 25, 1987 Public Hearing on HB 2145 before House Environment and Energy
24 Committee, Audio Tape 73, Side A.
25 ²⁰ HB 2145 House Environment and Energy Committee Exhibit F.
26 ²¹ *Id.* at 3.
²² *Id.* at 4.
²³ *Id.*
²⁴ *Id.* at 7.

1 Notably, the original version of HB 2145 granted the Commission discretion to authorize
2 a deferral for “*amounts incurred by a utility* the recovery of which the commission finds should
3 be deferred in order to minimize the frequency of rate changes or the fluctuation of rate levels or
4 to match appropriately the costs and benefits received by rate payers.”²⁵ Commissioner Davis
5 explained that the intent of this provision was to provide the Commission with authority “when a
6 legitimate *ratemaking* income or expense item is changing and the PUC believes rates should be
7 adjusted as a result, but finds that the rate changes should take place at some subsequent time”²⁶
8 and when it makes sense to match costs and benefits that occur over a long period of time.²⁷ At
9 NW Natural’s request, the language was changed to strike “amounts incurred by a utility,” and
10 add “utility expenses or revenues” to Section 2(2)(c).²⁸ John Lobdell, on behalf of NW Natural,
11 explained that the purpose of the amendment was to capture changes in the revenue side of utility
12 regulation—providing the example of changes in the industrial sales adjustment account (i.e. a
13 change in utility revenues that are sensitive to the volatility of oil prices).²⁹

14 NW Natural’s amendment to Section 2(2)(c), and the discussion of that amendment,
15 makes clear that “revenues” was intended to be defined as revenues as an offset to costs. The
16 inclusion of “revenues” was seen as additive to “expenses,” and provided the utility or another
17 party a mechanism to defer not just expense items, but revenues that offset utility expenses. The
18 term “expenses” was not explicitly defined in the legislative history of HB 2145. However,
19 types of utility “expenses” were discussed, and included items such as taxes, uncollectibles,
20 administrative costs, and operations and maintenance costs among several others.³⁰

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22 ²⁵ HB 2145 (as introduced).

23 ²⁶ HB 2145 House Environment and Energy Committee Exhibit A.

24 ²⁷ HB 2145 House Environment and Energy Committee Exhibit A (emphasis added).

25 ²⁸ NW Natural Amendments (March 25, 1987 - Exhibit D); March 25, 1987 Public Hearing on
26 HB 2145 before House Environment and Energy Committee, Audio Tape 73, Side A.

27 ²⁹ March 25, 1987 Public Hearing on HB 2145 before House Environment and Energy
28 Committee, Audio Tape 73, Side A.

29 ³⁰ HB 2145 House Environment and Energy Committee Exhibit F.

1 c. *The legislature failed to provide operative language that allows for the*
2 *deferral of the utility's rate of return.*

3 The issue of deferring capital investments was discussed and considered by legislators,
4 and both proponents and opponents of the bill. The legislative history contains statements that
5 suggest that the legislature thought that the legislation would allow the practice of deferring
6 capital investments, for a short period of time.³¹ However, the legislature failed to provide the
7 Commission with operative language upon which it could rely to continue the practice of
8 deferring the revenue requirement effects of capital investments, which includes the utility's
9 return on investment.³² It is well settled that Oregon courts are not at liberty to "give effect to
10 any supposed intention or meaning in the legislature, unless the words to be imported into the
11 statute are, in substance at least, contained in it."³³ The deferral of a utility's return on
12 investment would require the Commission to interpret either "revenues" or "expenses" in the
13 deferral statute to include the utility's authorized rate of return. As discussed above, such an
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16 ³¹ The current and intended future deferral of capital costs was discussed at length at public
17 hearings and work sessions for the bill. March 11, 1987 Public Hearing on HB 2145 before
18 House Committee on Environment and Energy, Audio Tape 57, Side A; March 30, 1987 Public
19 Hearing on HB 2145 before House Committee on Environment and Energy, Audio Tape 75, Side
20 B. Additionally, the House Environment and Energy Committee and the Senate Business,
21 Housing and Finance Committee were both provided with a detailed description of deferred
22 accounts, including accounts tracking capital costs. HB 2145, House Environment and Energy
23 Committee (Exhibit F); Senate Business, Housing and Finance Committee (Exhibit D,
24 Attachment 2). Finally, HB 2145 Section 5, the grandfather provision of the bill, authorized the
25 Commission to include currently deferred amounts to be reflected in rates, but subject to the
26 requirement that utilities apply for reauthorization to continue the use of such accounts pursuant
to Section 2 of the bill. HB 2145, Section 5 ("Amounts that have accrued in deferred accounts
with commission authorization before the effective date of this 1987 Act also may be reflected in
rates. However, in order to continue to use such accounts the public utility shall apply for
authorization of the commission under subsection (2) of this section."). This subsection of the
statute was subsequently removed by HB 2630 during the 2001 legislative session, because the
circumstance for which it existed was no longer an issue. May 7, 2001 Public Hearing on HB
2630 before Senate Committee on Business, Labor and Economic Development.

³² *Patton v. Target Corp.*, 349 Or 230 (2010) (Oregon Supreme Court finding that "there is an
unabridged gap between what the legislature is said to have intended and what the words that the
legislature chose to use actually do" and that the legislature's method fell short of translating its
intent into operational language.).

³³ See e.g. *Whipple v. Howser*, 291 Or 475, 480 (1981).

1 interpretation is contrary to standard ratemaking treatment for a utility's rate of return, which is
2 its own separate element of the ratemaking equation as discussed above.

3 The statute does not contain operative language upon which the Commission can rely to
4 defer a utility's return on investment, or more generally the revenue requirement effects
5 associated with a capital investment. In order to defer revenue requirement effects, one would
6 have to conclude that revenue requirement effects are synonymous with either "revenues" or
7 "expenses" under ORS 757.259(2)(e). Revenue requirement, however, is separately defined in
8 ratemaking and represents "the sum total of the revenues required to pay all operating and capital
9 costs of providing service."³⁴ Revenue requirement represents the sum of the ratemaking
10 formula, rather than a discrete portion thereof. Revenue requirement effects of capital
11 investments necessarily include utility "revenues" and "expenses," related to the capital
12 investment in question, but also include a return on the utility's rate base for that capital
13 investment.

14 Moreover, if "revenue requirement" was intended to be included in the definition of
15 "revenues," there would be no need to include "or expenses" because revenue requirement
16 necessarily includes both utility revenues and expenses. The inclusion of "expenses" would be
17 redundant and meaningless, contrary to the requirement that potentially inconsistent provisions
18 of a statute must be interpreted so as to give effect to all provisions if possible.³⁵

19 2. Deferring return on utility investment is also not supported by sound policy.

20 A utility's authorized rate of return on rate base is generally synonymous with the
21 utility's cost of capital, which is necessary to recover the utility's cost of debt, cost of preferred
22 stock and cost of equity. The utility's rate of return "reflects the risks of recovery that the utility
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25 ³⁴ HB 2145 House Environment and Energy Committee Exhibit F, Attachment 2: Deloitte
26 Haskins & sells – glossary "revenue requirement." "The sum total of the revenues required to
pay all operating and capital costs of providing service."

³⁵ ORS 174.010.

1 confronts trying to collect its revenue requirement.”³⁶ The Commission’s current policy for
2 deferred amounts is that they earn interest at the utility’s regulated rate of return unless and until
3 the Commission approves the amortization of deferred amounts into rates.³⁷ Once amounts are
4 approved for amortization, the utility earns interest at the blended treasury rate.³⁸

5 As such, for deferrals of revenue requirement effects of capital investments, the utility
6 would be effectively earning a return on its return on investment, as the deferral of revenue
7 requirement effects, or simply the deferral of capital costs including the utility’s rate of return,
8 are booked to an account that earns interest at the utility’s rate of return. Typically, rates
9 “provide the utility’s investor with *an opportunity* to earn a return that is commensurate with
10 those earned in the enterprises of similar risk and sufficient to enable the company to attract
11 capital;”³⁹ by allowing a return on utility investment to be deferred, customers would be paying
12 more than they otherwise would if costs were subject to recovery in a general rate case without a
13 similar basis in ratemaking principles.

14 **(B) The Commission should not defer return of utility investment as a matter of policy.**

15 Although, as discussed above, the Commission lacks the legal authority to defer the
16 utility’s rate of return on rate base, there is no clear legal prohibition against deferring the return
17 of a utility capital investment.⁴⁰ Nonetheless, sound policy weighs against deferring the utility’s
18 return of capital costs. First, deferrals are, in and of themselves, extraordinary ratemaking
19 treatment that the Commission has cautioned should be utilized sparingly. Second, other

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21 ³⁶ *In re Public Utility Commission of Oregon*, OPUC Docket No. 1147, Order No. 06-507 at 5
(Sept. 6, 2006)

22 ³⁷ *In re Public Utility Commission of Oregon*, OPUC Docket No. UM 1147, Order No. 05-1070
at 14 (Oct. 5, 2005).

23 ³⁸ *In re Public Utility Commission of Oregon*, OPUC Docket No. UM 1147, Order No. 08-263 at
24 15-16 (May 22, 2008).

25 ³⁹ *In re Qwest*, OPUC Docket No. UT 125/UT 80, Order No. 00-191 at 25 (Apr. 14, 2000)
(emphasis added).

26 ⁴⁰ Staff notes that the utility’s expenses and revenues associated with capital investment, such as
variable operations and maintenance costs, are appropriately subject to the deferral statute as
they represent costs and revenues outside of the utility’s rate base.

1 ratemaking alternatives to deferrals exist such that the utility is not harmed. In a previous
2 general investigation into deferrals, the Commission declined to adopt specific limitations to
3 deferrals, but recognized that the nature of the event and the magnitude of the event's impact on
4 a utility's costs or revenues should be considered when evaluating deferrals.⁴¹ The reasons
5 articulated for limiting the use of deferrals, generally, support eliminating the use for deferrals of
6 capital investment in light of the unique circumstances present with capital investments. Should
7 the Commission decline to adopt a general policy against the use of deferrals for capital
8 investment, the Commission may continue to determine whether a deferral is appropriate on a
9 fact-specific basis, and subject to its current deferral standards for revenues and expenses.

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11 1. Deferrals constitute extraordinary ratemaking treatment, and are a matter of
Commission discretion.

12 The legislature's intent in enacting HB 2145 was to provide the Commission with
13 necessary statutory authority to grant deferrals, as the Commission has no independent authority
14 to authorize the use of deferrals.⁴² Deferrals are necessary in order to avoid violating the rule
15 against retroactive ratemaking, which prohibits the inclusion of past profits or losses in the
16 setting of future rates.⁴³ The rule "protects ratepayers by ensuring that they know the maximum
17 cost of service at the time they use the service," and promotes efficient utility operations by
18 encouraging utilities to control costs between rate cases, and rewards utilities for efficient
19 management of their operations.⁴⁴ Importantly, while characterized as a "rule," the rule against
20 retroactive ratemaking is rooted in law.⁴⁵ As such, exceptions to the rule are viewed as
21 exceptional ratemaking treatment.

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24 ⁴¹ Order 05-1070 at 7.

25 ⁴² Or. Op. Atty. Gen. OP-6076 (Or.A.G.), 1987 WL 278316.

26 ⁴³ *Id.* at 1.

⁴⁴ *Id.* at 3.

⁴⁵ *Id.*

1 The Commission has acknowledged the exceptional nature of deferrals,⁴⁶ noting that
2 “deferrals should be used sparingly.”⁴⁷ Furthermore, the Commission has stated that “[i]n
3 exercising our discretion under ORS 757.259(2), we will consider whether there are other, more
4 appropriate regulatory tools to address recovery of the identified costs or revenues,” which
5 include general rate proceedings.⁴⁸

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7 2. The Commission should decline to exercise its discretion to allow the deferral of
return of utility investment.

8 The Commission should adopt a policy against deferrals for capital investment. Staff
9 recognizes there are instances where the Commission has approved deferrals for revenue
10 requirement effects of capital in the past (including return of utility investment), but has not done
11 so as part of an intentional, overall policy; rather, the Commission has often done so through
12 either the public meeting process based upon Staff’s recommendation or adopting stipulations,
13 both in an effort to facilitate a desired regulatory outcome.⁴⁹ Staff also recognizes that there are
14 currently approved and pending deferral applications for capital investments, some or all of
15 which include a return on utility investment, which will need to be addressed outside of this
16 proceeding. Adopting Staff’s recommendation, however, is supported by sound policy.

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18 ⁴⁶ *In re Oregon Public Utility Commission*, OPUC Docket No. 1147, Order No. 06-507 at 4
(Sept. 6, 2006) (“Deferred accounting is a discrete and *exceptional* ratemaking process...”)
(emphasis in original).

19 ⁴⁷ Order 05-1070 at 10.

20 ⁴⁸ *Id.*

21 ⁴⁹ *See e.g. In re Idaho Power Company*, OPUC Docket No. UM 1583, Order No. 12-109 (Mar.
22 27, 2012) (Commission granting application to defer the variance between revenues resulting
23 from the rates that include pollution control investments at the Jim Bridger plant and revenues
24 resulting from rates without the pollution control investments.); *In re Idaho Power Company*,
25 OPUC Docket No. UM 1597, Order No. 12-226 (Jun. 19, 2012) (Commission granting
26 application to defer the variance between revenues from rates that include the Langley Gulch
Power Plant revenue requirement and revenues from rates without the inclusion of the Langley
revenue requirement); *In re Portland General Electric*, OPUC Docket No. UM 1513, Order No.
11-153 (May 10, 2011) (Commission granting application to defer the revenue requirement
associated with four capital projects related to cyber security, information technology upgrades,
upgrades to Coyote Springs plant, and emission control investments at Boardman); *In re Avista
Utilities*, OPUC Docket No. UG 201, Order No. 11-080 (May 10, 2011) (Commission granting
deferral for two capital additions not yet used and useful at the conclusion of the rate case).

1 First, depreciation expense, which constitutes the return of utility capital investment, is
2 distinct from other expenses in that it does not require a cash outlay from the utility. Rather,
3 depreciation expense is recovered pursuant to ORS 757.140, and is based on straight-line and
4 remaining life, meaning that lawful recovery does not depend on precisely matching service with
5 the consumption of the resource.

6 Second, unlike utility revenues and expenses, a utility's ability to recover capital
7 investment is not dependent on inclusion in rates from the outset or deferred accounting. Once
8 an expense or revenue is incurred, absent a deferral, a utility cannot pass the item through for
9 ratemaking purposes as doing so would violate the rule against retroactive ratemaking. The
10 same is not true for capital investments, however. Although only the undepreciated capital
11 investment may be passed through at the time the capital investment is included in rates, the
12 whole of the utility investment is not lost without a deferral. Rather, the investment is subject to
13 regulatory lag, which provides an incentive for utilities to manage costs between rate cases. And
14 importantly, utilities control the timing of capital investments and rate cases. Therefore, they are
15 able to time general rate cases such that capital investment can be included when setting base
16 rates.


17 Finally, declining to allow deferrals for capital investments is not inconsistent with the
18 Commission's current policy regarding its exercise of discretion. The Commission's current
19 policy is to evaluate deferral applications based on a two interrelated factors—the type of event
20 giving rise to the deferral and the magnitude of the event's effect.⁵⁰ For risks that can be
21 reasonably predicted to occur in the normal course of events (stochastic risks), the financial
22 impact to the utility must be substantial enough to warrant deferral; for risks that are difficult or
23 impossible to predict and quantify (scenario risks), the impact of the event may be less
24 substantial.⁵¹ By nature, capital costs are predictable and are not included in rates until used and
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26 ⁵⁰ Order 05-1070 at 3.

⁵¹ *Id.*

1 analysis or policy considerations discussed above. Other ratemaking mechanisms are more
2 appropriate for addressing the inclusion of capital investment in rates.

3 DATED this 16th day of February, 2017.

4 Respectfully submitted,
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