1 **BEFORE THE PUBLIC UTILITY COMMISSION**
OF OREGON

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3 **UM 1147**

In the Matter of PUBLIC UTILITY COMMISSION OF OREGON Staff Request to Open an Investigation Related to Deferred Accounting	STAFF OPENING COMMENTS

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8 Pursuant to the hearing officer's January 25, 2006 Prehearing Conference Memorandum,
9 staff of the Public Utility Commission of Oregon ("staff") files these comments to address the
10 following issue, "whether a different rate of interest should be applied to authorized deferred
11 accounts during amortization." Because of the unique nature of deferred amounts, staff believes
12 the answer to this question is "yes."

13 Currently, the interest rate applied to deferred accounts is the utility's Authorized Rate of
14 Return ("AROR"). A utility's AROR is commensurate with return on investments in other
15 enterprises having corresponding risk. *See* ORS 756.040. Capital investments to which the
16 authorized rate of return (AROR) is applied include generation, transmission and distribution
17 plant. The investment risk profile for these items includes many considerations such as
18 regulatory oversight of prudence, the vagaries of weather on kWh sales levels, plant
19 performance, customer growth, technological innovation and likely challenges to cost recovery
20 by outside parties. In other words, there is regulatory risk associated with investment in the
21 assets, economic risk with regard to performance and value of the assets and finally, political risk
22 that the utility will not be allowed to recover its costs.

23 The risk of non-recovery also applies to deferred accounts until the Commission
24 determines how much will be recovered from, or refunded to, customers. In contrast, once
25 deferred amounts have been approved for amortization, utilities have very little risk of non-
26 recovery. (*See* OPUC Order No. 05-1070 at 14.) The absence of risk associated with the

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1 utilities' recovery of deferred amounts that are to be amortized justifies application of an interest
2 rate that is lower than the authorized rate of return applied to the utilities' capital investments.
3 In previously-filed comments, Portland General Electric Company ("PGE") argues it is
4 not appropriate to distinguish between deferred amounts and other investments for purposes of
5 determining the proper return because 1) utilities fund deferred accounts just like any other
6 capital investment and 2) singling out deferred accounts for a lower interest rate would be
7 discriminatory because utilities have high risk investments that are not singled out for a higher
8 interest rate.
9 PGE's arguments are without merit. First, even putting aside the issue of risk; deferred
10 accounts are not like capital investments. In fact, they are not investments at all. Nor are they
11 forecasted in the capital budgeting process. Deferred accounts are either a regulatory-created
12 asset or regulatory-created liability. As such, a utility cannot argue that it funds deferred
13 accounts like any other capital investment.
14 Moreover, the overall AROR is not the weighted average of all sources of funds.
15 Contrarily, the AROR is only the weighted average of equity, preferred stock and long-term
16 debt. The calculation of AROR does not include deferred amounts, nor does it include short-
17 term debt and other sources of funds.[1] Because AROR is only for a subset of the utilities'
18 sources of funds, the Commission should not conclude that the AROR should apply to all utility
19 funds.
20 PGE's argument that its AROR should apply to its deferred accounts would have more
21 merit if deferrals, short-term debt and all other sources of funds other than equity, preferred stock
22 and long-term debt, were included in the calculation of AROR. They are not, however.
23 Accordingly, there is little reason to assume that it is appropriate to apply AROR to deferred
24 amounts that are subject to amortization. The AROR is applied to ratebase, which staff assumes
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26 [1] *See* OPUC Order No. 01-787 ("[I]t has been Commission practice to remove short-term debt . . . from calculations of debt rates for rate cases.")

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1 the utilities' fund with long-term debt, preferred stock and equity. It is appropriate to match the
2 utilities' long-term assets (ratebase) with long-term funding sources. Conversely, it is not
3 necessarily appropriate to match the utilities' short-term assets or liabilities with the cost of its
4 long-term funding sources. Although amortization periods for deferred accounts vary, it is
5 common for the Commission to authorize recovery or refund over 12 months.
6 PGE's argument that it is discriminatory to single out deferred accounts for different
7 treatment is also meritless. First, as noted previously, there are reasons to treat deferred amounts
8 differently from capital investments. Furthermore, PGE's argument appears to assume that the
9 AROR currently applies to all the utilities' funds. It does not. For example, customer deposits
10 are a source of funds for PGE. The Commission set the cost of these funds at 4% for 2006. If it
11 is discriminatory to single out deferred accounts for a different interest rate, then it is also
12 discriminatory to single out customer deposits.
13 PGE's argument that singling out deferred accounts for a return would result in
14 asymmetrical ratemaking because higher risk investments are not singled out for a higher return
15 is also incorrect. To the extent the utilities' capital investments represent high risk, these risks
16 are captured in the AROR. However, the utilities' low risk associated with return of deferred
17 amounts subject to amortization is not.
18 Furthermore, the AROR is comprised of approximately 50% long-term debt. The "cost"
19 of long-term debt is the historic embedded cost. It makes no sense to assume that it is
20 appropriate to apply an AROR based in significant part on historic embedded costs to a utility's
21 incremental cost of debt. Instead, it is logical to assume that there is little relationship between
22 the utilities' historic cost of long-term debt and the incremental cost to utilities to obtain short-
23 term funds.
24 Providing an interest rate that does not match the incremental cost of funds to the
25 company complicates decisions regarding the length of the amortization. For large deferrals, a
26 longer amortization may mitigate rate shock, but it also provides a windfall to either customers

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1 or the company based on the relationship between the AROR and the true underlying
2 incremental cost of funds to the company. If AROR is greater than the incremental cost of
3 funds, and money is owed to the company, the amortization creates a windfall to the company.
4 The possibility of a windfall to the company is not a consideration if the incremental cost of
5 funds is used.
6 Except in circumstances mandated by the Commission, the utility determines when it will
7 file for a deferral. Because it is not in the company's interest to file for deferrals associated with
8 better-than-expected water years or other excess income generating events, a mismatch between
9 the incremental cost of funds and the AROR could allow the company to profit, at the expense of
10 its customers, from both from worse-than-expected and better-than-expected events.
11 For the reasons discussed above, it is appropriate to apply an interest rate to deferred
12 amounts that have been approved for amortization that reflects the risks, duration, and true cost
13 of funds needed to meet the obligations associated with deferred accounts. Accordingly, the
14 Commission should conclude an interest rate (or rates) that is lower than the utilities' authorized
15 rates of return should be applied to authorized deferred accounts during amortization.
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17 DATED this 16th day of March 2006.
18 Respectfully submitted,
19 HARDY MYERS
20 Attorney General
21
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CERTIFICATE OF SERVICE

I certify that on March 16, 2006, I served the foregoing upon the parties hereto by electronic mail and by sending a true, exact and full copy by regular mail, postage prepaid to the parties accepting paper service.

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