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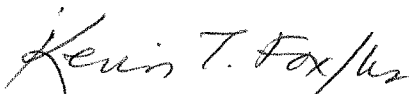
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Re: Docket UM 1147

I enclose for filing PacifiCorp's Reply Comments Phase II in the above-referenced docket. A copy of this filing has been served on all parties to this proceeding as indicated on the attached certificate of service.

Very truly yours,


Kevin T. Fox

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Enclosure
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BEFORE THE PUBLIC UTILITY COMMISSION
OF OREGON

UM 1147

In the Matter of
PUBLIC UTILITY COMMISSION OF
OREGON

PACIFICORP'S REPLY COMMENTS
PHASE II

Staff Request to Open an Investigation
Related to Deferred Accounting

I. INTRODUCTION

PacifiCorp respectfully submits the following reply comments in Docket No. UM 1147. In this second phase of UM 1147, the parties have been asked to address whether a different rate of interest should be applied to authorized deferred accounts during amortization. Prehearing Conference Memorandum Issued by ALJ Kirkpatrick, UM 1147 (Jan. 25, 2006).

The Commission should continue its policy of compensating utilities for the overall risk they bear and not depart from this policy in order to assign risk on an individual investment-by-investment basis. The Commission's current policy is fair, appropriate and easy to administer. In contrast, Staff's proposal fails to appreciate the risks associated with deferred accounting and lacks an understanding of the way utilities presently fund deferred accounts. For these reasons, Staff's proposal should be rejected and the Commission's current policy retained.

II. ARGUMENT

A. The Commission Should Apply an Interest Rate To Deferred Accounts That Reflects the Degree of Risk When Funds are Expended, Not the Degree of Risk After a Deferred Account Has Been Approved for Amortization.

Staff asserts in its phase II opening comments that "[t]he absence of risk associated with the utilities' recovery of deferred amounts *that are to be amortized* justifies application

1 of an interest rate that is lower than the authorized rate of return applied to the utilities’
2 capital investments.” Staff Comments at 1-2 (March 16, 2006) (*italics added*).

3 Rather than focus on the time at which funds are expended, Staff proposes that the
4 Commission look to a period after a deferred account is authorized and assign a
5 correspondingly low interest rate to the amounts that are authorized for recovery. This
6 approach has two fundamental flaws. First, it focuses on a utility’s risk of recovering
7 expenses once an expenditure has been authorized for recovery. Staff’s proposal does not
8 look at the risk of recovery at the time capital is expended. Second, Staff’s proposal only
9 looks at the risk of recovering amounts that are approved for deferred accounting, not the risk
10 of recovering the total amount a utility expends.

11 Cost of capital varies according to risks present when funds are obtained and
12 expended. In the case of deferred accounts, funds are often expended prior to amortization,
13 when risks equal those of capital investments to which a utility’s authorized rate of return
14 applies. *See* Staff Comments at 1 (March 16, 2006) (“The risk of non-recovery also applies
15 to deferred accounts until the Commission determines how much will be recovered from, or
16 refunded to, customers.”). Pre-amortization risks include the possibility that an investment
17 may be discounted or disallowed upon (a) prudence review, (b) earnings test, (c) sharing or
18 deadbands in a deferral mechanism, or (d) incursion of costs before the filing of a deferred
19 accounting application. Even post-amortization, investments may be discounted or
20 disallowed through a modification of a prior order authorizing deferred accounting. *See* Staff
21 Comments at 3 (Jan. 18, 2005). Thus, there is substantial risk associated with funds
22 expended in anticipation of deferred accounting. Staff’s proposal fails to adequately
23 compensate utilities for these risks.

24 Staff’s proposal also fails to reflect a utility’s risk of recovering the total amount it
25 expends. Instead, Staff’s proposal only looks at a utility’s risk of recovering amounts that are
26 authorized. This approach ignores the fact that the Commission often authorizes less than a

1 full recovery of expenditures. For example, the Commission authorized the recovery of only
2 half the money PacifiCorp expended on excess power costs during California’s energy
3 market failures. *See* UM 995, Order No. 02-469 at 2. As PGE states, an order authorizing
4 amortization of less than the full amount expended by a utility does not eliminate that
5 utility’s risk, it confirms it. PGE Comments at 3 (March 16, 2006).

6 Staff’s proposal also reduces the interest rate on authorized deferred accounts without
7 increasing the interest rate on expenditures made prior to deferred account authorization.
8 This is despite the fact that Staff acknowledges that substantial risk of non-recovery applies
9 to deferred accounts until the Commission determines how much will be recovered. Staff
10 Comments at 1 (March 16, 2006). Accordingly, Staff’s proposal is asymmetric and unfair to
11 shareholders who expend funds in the public interest.

12 If PacifiCorp had the foresight to predict whether the funds it expends “are to be
13 amortized” then Staff’s assertion of reduced risk may be valid. Unfortunately, PacifiCorp
14 lacks the ability to accurately predict whether the funds it expends will be recovered pursuant
15 to an authorization of deferred accounting. For this reason, it is inappropriate to assign a low
16 rate of return to an expenditure that bears significant risk of less than full recovery.

17 **B. The Commission Should Retain Its Policy of Applying a Utility’s**
18 **Authorized Rate of Return to Deferred Account Balances.**

19 Deferred expenses represent amounts expended by shareholders to serve the public.
20 Shareholders are entitled to the same return on these funds as they are authorized to receive
21 on other capital dedicated to public service.

22 Staff claims that “deferred accounts are not like capital investments,” therefore, “a
23 utility cannot argue that it funds deferred accounts like any other capital investment.” Staff
24 Comments at 2 (March 16, 2006). None of the utilities in this docket have argued that
25 deferred accounts are “like capital investments.” Rather, the utilities in this proceeding have
26

1 argued that deferred accounts are *funded just like any other capital expense* – with an
2 unspecified mix of debt and equity. PacifiCorp Comments at 2 (March 16, 2006); PGE
3 Comments at 2 (March 16, 2006); Idaho Power Comments at 3 (March 16, 2006). Since
4 deferred accounts are funded like other capital expenses, it is appropriate to assign the same
5 rate of return to deferred accounts as is assigned to other capital investments, namely the
6 utility’s authorized rate of return.

7 Staff also states that “it is not necessarily appropriate to match the utilities’ short-term
8 assets or liabilities [deferred accounts] with the cost of its long-term funding sources.” Staff
9 Comments at 3 (March 16, 2006). Staff seems to assume that PacifiCorp funds deferred
10 accounts through discrete acquisitions of short-term debt instruments. Because PacifiCorp
11 funds deferred accounts with debt and equity, it is appropriate to look to PacifiCorp’s long-
12 term funding sources, debt and equity, in assigning an interest rate to deferred accounts. *See*
13 Staff Comments at 4 (March 16, 2006) (“it is appropriate to apply an interest rate to deferred
14 amounts that have been approved for amortization that reflects the risk, duration, and true
15 cost of funds needed to meet the obligations associated with deferred accounts.”).

17 III. CONCLUSION

18 The Commission should retain its long-standing practice of applying a utility’s
19 authorized rate of return to deferred balances. If, however, the Commission decides to depart
20 from this policy, PacifiCorp believes that an evidentiary hearing with oral argument is
21 required since no evidence has been presented to indicate that PacifiCorp’s cost of carrying
22 its deferred balances is less than its costs of funding of other capital expenditures.

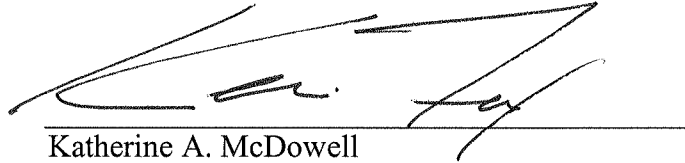
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DATED: April 21, 2006.

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CERTIFICATE OF SERVICE

1
2 I hereby certify that I served the foregoing document on the following named
3 person(s) on the date indicated below by

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8 to said person(s) a true copy thereof, contained in a sealed envelope, addressed to said
9 person(s) at his or her last-known address(es) indicated below.

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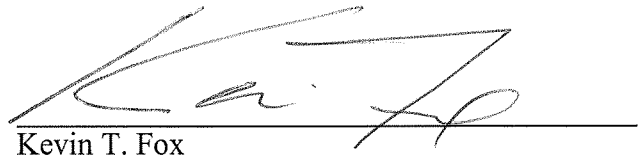
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